Petition

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No. 81-

IN THE

Supreme Court of the United States

October Term, 1981

PENNZOIL COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the court of appeals erred by judicially approving an unauthorized assertion of jurisdiction by the Federal Energy Regulatory Commission which not only undermines the producer pricing provisions contained in Title I of the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3311-3333, but also squarely contravenes the governing principles of law established by this Court under the *Mobile-Sierra* doctrine.

2. Whether the court of appeals erred in affirming orders of the Federal Energy Regulatory Commission which violate the direct congressional injunction that Natural Gas Policy Act prices are to be treated as just and reasonable prices under the Natural Gas Act.

3. Whether the court of appeals erred by *sua sponte* deciding a question which was foreclosed to it under Section 506 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3416.

PARTIES BELOW

Petitioners in this case,* all of whom participated in the case below, are:

Pennzoil Company
Pennzoil Producing Company
Pennzoil Oil and Gas, Inc.
General American Oil Company of Texas
Ashland Exploration, Inc.

In addition, the parties below were:

Amerada Hess Corporation
Aminoil USA, Inc.
Aminoil Development, Inc.
Aminoil of Louisiana, Inc.
American Independent Oil Company
Amoco Production Company
Arco Oil and Gas Company
Associated Gas Distributors
Atlantic Richfield Company
Cabot Corporation
Carnegie Natural Gas Company
Chevron U.S.A., Inc.
Cities Service Company
Columbia Gas Transmission Corporation
CONOCO Inc.
Consolidated Gas Supply Company
Damson Oil Corporation
ECEE, Inc.
Exxon Corporation

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*The following companies are the non-wholly owned subsidiaries of Pennzoil Company: National Transit Company, Pennesco, Inc., and The Eureka Pipe Line Company. Ashland Exploration, Inc. is a wholly owned subsidiary of Ashland Oil, Inc.

Gas Consumers Group**
Getty Oil Company
Gulf Oil Corporation
Hunt Oil Corporation
Independent Producers
Inexco Oil Company
Kerr-McGee Corporation
Marathon Oil Company
Memphis Light, Gas & Water Division
Michigan Public Service Commission
Mobil Oil Corporation
Mobil Oil Exploration and Producing Southeast Inc.
Mobil Producing Texas and New Mexico, Inc.
Mountain Fuel Supply Company
Northern Natural Gas Producing Company
Pacific Gas and Electric Company
People of the State of California and the Public Utilities Commission of the State of California
Phillips Petroleum Company
Pinto, Inc.
Placid Oil Company

**The Gas Consumers Group consists of the following municipal gas distribution and cooperative electric systems: Akron, Alabaster, Aliceville, Berry, Boaz, Brookside, Calera, Camp Hill, Childersburg, Chilton County Gas District, Dora, Electric, Eden, Fayette, Fultondale, Gordo, Graysville, Jacksonkville, Jasper, Helena, Hokes Bluff, Lafayette, Lamar County Gas District, Lanett Livingston, Marshall County Gas District, Montevallo, Mulga, Northwest Alabama Gas District, Oakman, Oak Ridge, Oneonta, Parrish, Pell City, Phoenix City, Piedmonth, Pleasant Grove, Quinton, Ragland, Scottsboro, Southeast Alabama Gas District, Steele, Sumiton, Sylacauga, Tallassee, Trussville, Union Springs, Vincent, Wilcox Gas District, Wilton, York, West Point, Cairo, Chambersburg, Franklin, Huntingburg, Pulaski, Smyrna, Utica, Atmore, Brewton, Bay Minette, Conecuh-Monroe Counties Gas District, Fairhope, Foley, Okaloosa Gas District, Pensacola, Charlottesville, and Western Farmers Electric Cooperative.

Pogo Producing Company
Public Utilities Commission of Minnesota
Public Service Commission of New York
Public Utilities Commission of South Dakota
Rhode Island Division of Public Utilities & Carriers
Shell Oil Company
Southern California Gas Company
Sun Oil Company (Delaware)
The Superior Oil Company
Tenneco Oil Company
Tennessee Gas Pipeline Company
Terra Resources, Inc.
Texaco, Inc.
Texasgulf Inc.
Texas Gas Transmission Corporation
Texas Production Company
Transcontinental Gas Pipeline Corporation
Union Oil Company of California
Williams Exploration Company

TABLE OF CONTENTS

Page

Questions Presented for Review i

Parties Below ii

Opinions and Orders Below 1

Jurisdiction 2

Statutes Involved 2

Statement of the Case 2

Reasons for Granting the Writ 12

Conclusion 26

Appendix

TABLE OF CITATIONS

Cases

Page

FPC v. Sierra Pacific Power Co.,
350 U.S. 348 (1956) 11, 17

In re Permian Basin Area Rate Cases,
390 U.S. 747 (1968) 6, 22

Pennzoil Co. v. FERC,
645 F.2d 360 (5th Cir. 1981) 11

Phillips Petroleum Co. v. Wisconsin,
347 U.S. 672 (1954) 21

United Gas Pipeline Co. v. Memphis Light, Gas &
Water Division, 358 U.S. 103 (1958) 18

United Gas Pipeline Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) 11, 16, 20

Statutes

Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 ..... *passim*

Natural Gas Act of 1938, 15 U.S.C. §§ 717-717w ..... *passim*

Administrative Authorities and Regulations

Order No. 232, 25 F.P.C. 379, *modified,* Order No. 232-A, 5 F.P.C. 609 (1961), *petition for review dismissed,* Sun Oil Co. v. FPC, 304 F.2d 293 (5th Cir.), *cert. denied,* 371 U.S. 861 (1962). 5

Pure Oil Co., 25 F.P.C. 383 (1961), *aff'd,* Pure Oil Co. v. FPC, 299 F.2d 370 (7th Cir. 1962) 5

Order No. 329, 36 F.P.C. 923 (1966) 6

Opinion No. 468, 34 F.P.C. 159, *modified,* Opinion No. 468-A, 34 F.P.C. 1068 (1965), *aff'd, In re* Permian Area Rate Cases, 390 U.S. 747 (1968), *implemented,* 40 F.P.C. 242 (1968), *aff'd,* Phillips Petroleum Co. v. FPC, 405 F.2d 6 (10th Cir. 1969) 22

Opinion No. 699, 52 F.P.C. 1604 (1974), *aff'd,* Shell Oil Co. v. FPC, 520 F.2d 1061 (1975), *rehearing denied,* 525 F.2d 1061 (5th Cir.), *cert. denied,* 426 U.S. 941 (1976) 22

Gulf States Utilities Co. v. FPC, ___ F.P.C. ___, 9 Fed. Pwr. Serv. 5-100 (1976) 19

Other Sources

STAFF OF THE SUBCOMM. ON ENERGY AND POWER OF THE HOUSE COMM. ON INTERSTATE COMMERCE, ECONOMIC ANALYSIS OF H.R. 5289, NATURAL GAS POLICY ACT OF 1978, 95TH CONG., 2D SESS. (Comm. Print No. 62, 1978) 13

An Evaluation of Natural Gas Pricing Proposals, Analysis Memorandum No. AM/IA-7902, DOE/EIA (6/14/78) 13

The Natural Gas Compromise, Natural Resources and Commerce Division, Congressional Budget Office (8/2/78) 13

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v.

FEDERAL ENERGY REGULATORY COMMISSION,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Pennzoil Company, Pennzoil Producing Company, Pennzoil Oil and Gas, Inc., General American Oil Company of Texas, and Ashland Exploration, Inc., petition for a writ of certiorari to review the May 20, 1981, decision of the United States Court of Appeals for the Fifth Circuit involving orders of the Federal Energy Regulatory Commission (FERC). These orders prescribe substantive and procedural rules pertaining to the legal rights of producers of natural gas to collect prices prescribed by the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432, for wellhead sales of natural gas.

OPINIONS AND ORDERS BELOW

The decision of the United States Court of Appeals for the Fifth Circuit in *Pennzoil Company, et al. v. FERC*, Nos. 79-1247 and -1602, is reported at 645 F.2d 360 (5th

Cir. 1981); a copy of that decision is set out at Appendix A. The eight orders issued by the FERC that were the subject of the court of appeals' decision appear at Appendix B.

JURISDICTION

The judgment of the court of appeals was entered on May 20, 1981. Petitions for Rehearing were filed with the court of appeals by Pennzoil Company, *et al.*, and Phillips Petroleum Company on June 3, 1981. The court of appeals has not acted on these petitions as of this date.

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

The statute upon which the court of appeals' decision is based is the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432, the relevant portions of which appear at Appendix C. Integral to the decision is the Natural Gas Act of 1938 (Gas Act), 15 U.S.C. §§ 717-717w, the relevant portions of which appear at Appendix D.

STATEMENT OF THE CASE

A. Introduction

The instant case focuses on the overlay of the producer pricing provisions of the Natural Gas Policy Act of 1978 upon the regulatory scheme embodied in the Natural Gas Act of 1938. Specifically, Petitioners seek this Court's review of orders of the FERC, affirmed on point by the court of appeals, by which the agency eviscerated the integrity of the producer pricing scheme enacted by Con-

gress in Title I of the NGPA and assumed unto itself the right effectively to review the propriety of policy balances struck by Congress in that legislation.

The FERC's action has two predicates. First, it has interdicted the contractual sufficiency of certain clauses, known as area rate clauses, to collect ceiling just and reasonable prices established by Congress in Title I of the NGPA. These clauses have consistently and conclusively operated as contractual authority to collect just and reasonable ceiling prices established by the FERC pursuant to the delegation of legislative authority by Congress under the Gas Act. Now, however, that Congress has itself exercised the legislative authority to establish ceiling just and reasonable rates, the FERC, with the approval of the court of appeals, has rendered the operation of such clauses conditional upon a hearing, even when the form of the clause is exactly that prescribed by the FERC.

The second predicate by which the FERC has interdicted the previously conclusive operation of area rate clauses to collect ceiling just and reasonable prices is by an expansion of its jurisdiction in direct violation of the governing precedents of this Court. Under those precedents, private parties have the right to contract without interference so long as the resulting price does not exceed the ceiling just and reasonable price. Yet under the FERC's orders, persons not parties to the contracts may challenge the agreement of the parties notwithstanding that such agreement does not result in the charging or collection of a rate in excess of the ceiling just and reasonable rate.

The result of these orders is that virtually every interstate gas contract is being challenged in administrative hearings, and billions of dollars of potential refunds are at

stake. And the effect of those challenges is to deny the NGPA its intended operation. Petitioners submit that this Court's review is essential to eliminate the unwarranted and improper impediments to NGPA implementation and to restore thereby the integrity of the producer pricing scheme enacted by Congress.

B. Facts

On November 9, 1978, the NGPA was enacted into law.[1] In that statute, Congress used its legislative authority, theretofore delegated to the FERC, to establish new just and reasonable rates for the wellhead sale of natural gas. For certain categories of natural gas, it again delegated to the FERC the authority to prescribe even higher rates. At the same time, the statute reduced the certificate jurisdiction of the FERC over producers of natural gas. In essence, the NGPA was designed as a *deregulation* bill attempting to effect natural gas price increases gradually until 1985, at which time natural gas prices for new gas was to equate with projected crude oil prices, and partial gas deregulation was to occur.

To minimize the disruption that frequently accompanies a major change in legislation, the NGPA was designed to overlay and be engrafted onto the Gas Act and the scheme of regulation which had evolved thereunder. In this regard, Congress, in Section 601(b)(1)(A) of the Act, mandated that the prices prescribed pursuant to the NGPA shall be deemed to be just and reasonable for purposes of the Gas Act.[2] The effect was that although the FERC was granted

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[1] Pub. L. No. 95-621, 92 Stat. 3350 (1978) (codified at 15 U.S.C. §§ 3301-3432).

[2] *Id.* §3431(b)(1)(A).

the power to increase certain of the prices established pursuant to the NGPA, it was prohibited from reducing such prices. As with the Gas Act, administration and implementation of the NGPA pricing provisions was entrusted to the FERC.

On November 29, 1978, the FERC issued its Interim Regulations Implementing the NGPA, effective December 1, 1978.[3] One section of those regulations cast doubt upon whether area rate clauses would be allowed to operate as contractual authority to collect the NGPA ceiling price for which the gas was eligible.

Area rate clauses resulted from actions of the Federal Power Commission (FPC), the FERC's predecessor agency.[4] In 1961, the FPC promulgated regulations prohibiting indefinite price escalator clauses in interstate gas purchase contracts.[5] The regulations were amended in 1966 to allow

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[3] Appendix B.1.

[4] The Federal Power Commission was succeeded by the FERC as of October 1, 1977, pursuant to the provisions of the Department of Energy Organization Act, Pub. L. No. 95-91. References to the FERC herein include, as appropriate, reference to the predecessor agency.

[5] 18 C.F.R. § 154.93. *See* Pure Oil Co., 25 F.P.C. 383 (1961), *aff'd*, Pure Oil Co. v. FPC, 299 F.2d 370 (7th Cir. 1962); FPC Order No. 232, 25 F.P.C. 379, *modified*, Order No. 232-A, 25 F.P.C. 609 (1961), *petition for review dismissed*, Sun Oil Co. v. FPC, 304 F.2d 293 (5th Cir.), *cert denied, 371 U.S. 861 (1962).*

The Commission historically encouraged interstate pipelines to enter into long term gas purchase contracts. As a result, gas purchase contracts are generally of a 20 year or longer term. Producers were reluctant to enter into such long-term contracts on a fixed price basis, and hence negotiated for a wide variety of indefinite price escalator clauses which would increase the price of the gas on the occurence of specified triggering events. The Commission's prohibition on the operation of these clauses was premised upon its conclusion that indefinite price escalator clauses could operate to increase the price of

the use of "[p]rovisions that permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of gas involved,"[6] *i.e.*, area rate clauses.[7]

The doubt that was thrown upon the operation of area rate clauses was wholly unpreceented and unforseen for: (1) such clauses had always been presumed by the FERC in the past to constitute contractual authority to collect ceiling prices of general applicability which were deemed to be just and reasonable for purposes of the Gas Act; (2) prices established pursuant to the NGPA are ceiling prices of general applicability; and (3) Congress had decreed that NGPA ceiling prices shall be deemed to be just and reasonable for purposes of the Gas Act.

Because of the uncertainty over exactly what the FERC intended in issuing its regulations, extensive comments

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gas by reference to events that were not economically significant to the price of gas subject to the contract, thus resulting in an unjust and unreasonable price. Hence, the abrogation of these clauses was deemed to be required by the public interest.

[6]18 C.F.R. § 154.93(b-1). Order No. 329, *Permissible Provisions for Price Changes in Producer Rate Schedules,* 36 F.P.C. 925 (December 1, 1966). The 1966 amendment was prompted by the Commission's abandonment of individual producer ratemaking in favor of an area rate approach. *See In re* Permian Basin Area Rate Cases, 390 U.S. 656 (1961). 18 C.F.R. § 154.93(b-1) was premised upon the assumption that the establishment of a just and reasonable rate applicable for a specified category of gas was an economically significant event and thus collection of such rate was in the public interest.

[7]As discussed more fully *infra,* the Gas Act authorized the establishment of ceiling prices but did not interfere with the right of producers and purchasers to set a price by contract that was less than or equal to the ceiling rate. Hence, any increase in the contract price to an increased just and reasonable ceiling price had to be authorized by the terms of the contract. Area rate clauses provided contractual authority for the contract price to track the ceiling price.

were submitted to the FERC by interested parties. Petitioners urged the FERC to resolve all doubts by recognizing that NGPA ceiling prices are "just and reasonable" for purposes of the Gas Act and that area rate clauses operate to permit the collection of applicable just and reasonable prices.

The FERC rejected those arguments, and in its *FERC Policy Respecting Area Rate Clauses and Indefinite Price Escalator Clauses,* issued January 24, 1979,[8] held that as a matter of law area rate clauses do not constitute "contractual authority" for the collection of NGPA prices. Following the issuance of the *FERC Policy,* the FERC issued a Notice of Proposed Rulemaking in FERC Docket No. RM79-22 to promulgate specific regulations pertaining to area rate clauses and NGPA prices.[9]

The Notice of Proposed Rulemaking resulted in a series of FERC orders under Docket No. RM79-22. The first of these orders was Order No. 23.[10] Ostensibly reversing its previous position set out in the *FERC Policy,* the FERC expressly recognized that NGPA rates are just and reasonable and conceded that area rate clauses could provide sufficient contractual authority to collect NGPA maximum lawful ceiling prices. In a marked departure from its historic treatment of area rate clauses, however, the FERC held

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[8]Appendix B.2.

[9]Notice of Proposed Rulemaking, *Amendments and Clarification of the Commission's Interim Regulations Under the Natural Gas Policy Act of 1978 and Regulations Under the Gas Act,* Docket No. RM79-22 (February 13, 1978).

[10]Order No. 23, *Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act,* Docket No. RM79-22 (March 13, 1979) [Appendix B.3.].

that area rate clauses are inherently ambiguous with respect to the collection of NGPA prices and thus case-by-case proceedings would be established to interpret the parties' contract.[11] The FERC reached this holding notwithstanding its observance that the vast majority of producers and pipelines did not regard their area rate clauses as ambiguous but rather as clearly providing contractual authority to collect just and reasonable rates of general applicability such as NGPA rates.[12]

The effect was to establish two classes of just and reasonable prices: those declared by the FERC to be just and reasonable pursuant to authority delegated to it by Congress under the Gas Act, which prices would be given effect as just and reasonable prices for all purposes, and those declared by Congress to be just and reasonable prices for purposes of the Gas Act. As to these latter prices, the FERC would give them effect as just and reasonable only to such extent as it, in its discretion, determined proper notwithstanding the congressional admonition that such prices *are* to be deemed just and reasonable. The result of this bifurcation is that the FERC has effectively denied NGPA prices the just and reasonable status mandated for them by Congress.

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[11]The FERC noted that its practice had been to presume conclusively the contractual authority of area rate clauses, requiring "as a matter of public policy only that the rates be controlled, that they be just and reasonable, that they be generally applicable to an area, and that they apply to the quality of the gas involved (*i.e.*, vintage). The Natural Gas Policy Act maximum ceiling prices fit each of these criteria." R. 1086-1087.

[12]The FERC noted that "[m]ost sellers of natural gas in the interstate market have taken the view that the intent of the parties in agreeing to an area rate clause was to permit escalation to the highest ceiling price permitted by law" and "[m]ost interstate pipelines purchasers have endorsed this position." R. 1088-1089.

Despite the fact that the NGPA was intended to reduce the FERC's jurisdiction over producers, the FERC then embarked upon an unprecedented expansion of its jurisdiction. It established procedures whereby its staff and other persons not parties to contracts for wellhead sales of gas would have the right to challenge the contractual authority of producers to receive payment of applicable NGPA prices even though neither the producer sought to charge, nor the pipeline to pay, a price in excess of the applicable maximum lawful price. This protest right would arise, the FERC held, even where the contracting parties mutually assert that their area rate clause provides contractual authority for the producer to collect applicable just and reasonable NGPA prices. This protest right had never been entertained by the FERC under the maximum lawful pricing scheme of just and reasonable prices administered by it under the Gas Act.

The FERC further held that pipelines could protest a producer's assertion of contractual authority to collect NGPA prices pursuant to an area rate clause; if such protest was raised, the traditional presumption that area rate clauses provide contractual authority to collect just and reasonable rates of general applicability would no longer be accorded. Rather, the FERC held that in such an event, a producer would be required to prove contractual authority that was, and continues to be, conclusively presumed with respect to just and reasonable rates prescribed under the Gas Act.

The revocation of the traditional presumption was particularly noteworthy in view of the FERC's recognition of its obligation to treat NGPA rates as just and reasonable for purposes of its Gas Act au[illegible]rity,[13] and its admission

[13] 1061.

that area rate clauses have, since their inception, operated to provide contractual authority to charge and collect just and reasonable rates.[14]

Finally, the FERC stated that it would apply general principles of contract law to the resolution of both pipeline and third party protests, and would entertain such protests as to the collection of any NGPA price category, even those removed from its jurisdiction by the NGPA.

Thereafter, the FERC issued Order Nos. 23-A and 23-B. Order No. 23-A recognized the right of producers and pipelines to amend their contracts.[15] And Order No. 23-B set out specific procedures for the conduct of the nonparty protest established in Order No. 23.[16] Since the issuance of these orders, over 10,000 natural gas sales contracts have been protested as providing insufficient contractual authority for the payment and collection of "just and reasonable" rates under the NGPA, despite the existence of an area rate clause. If a producer's contract is protested, the producer may collect NGPA rates, but only subject to refund.

Timely petitions for review of the orders were filed in the United States Court of Appeals for various circuits. By Order entered May 28, 1980, the United States Court of Appeals for the Fifth Circuit determined that it had jurisdiction and venue in the matter and ordered all cases pending in other circuits transferred to it and consolidated.

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[14]R. 1086-1087. See note 11 *supra.*

[15]Order No. 23-A, *Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations under the Natural Gas Act* (June 12, 1979) [Appendix B.5.].

[16]Order No. 23-B, *Adopting Final Regulations and Establishing Protest Procedures* (June 21, 1976) [Appendix B.6].

On May 20, 1981, the court of appeals rendered its decision.[17] Generally affirming the orders of the FERC, the court held that the FERC's interpretation of area rate clauses was not plainly erroneous or inconsistent with the NGPA.[18] The court sustained the FERC's novel expansion of its jurisdiction to interject its staff and other persons not parties to the contract into the private contractual relationship of the parties for the purpose of disputing the mutual interpretation of contractual provisions ascribed by the parties, in direct contravention of the *Mobile-Sierra* doctrine[19] The court also sustained the FERC's abandonment of its area rate clause presumption, notwithstanding the command of Section 601 that NGPA rates be treated as just and reasonable rates under the Gas Act. By this affirmance, the court failed to give effect to Section 601 of the NGPA and ignored the existence of a well established and critical presumption.

The court, however, reversed the FERC to the extent that contract interpretation in protest proceedings was to be based upon general principles of contract law. The court ruled that under the *Erie* doctrine, the FERC was required to apply applicable state contract law.[20] Nevertheless, the court maintained that strangers to the contract had the right to protest the mutual interpretation of the parties even though such right is not accorded under the laws of any state.[21] The court further held that the FERC lacks jurisdiction to entertain protests and interpret con-

[17] Pennzoil Co., *et al.*, v. FERC, 645 F.2d 360 (5th Cir. 1981).

[18] *Id.* at 383.

[19] The *Mobile-Sierra* doctrine derives its name from two cases decided by this Court: *United Gas Pipeline Co., v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956) and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

[20] 645 F.2d at 387.

[21] *Id.* at 391.

tract provisions with respect to those categories of natural gas removed from its jurisdiction under the NGPA, and hence modified the orders in this respect. Finally, it determined the operation of certain pricing clauses in intrastate contracts, a question addressed by the court *sua sponte* without any opportunity for briefing by the parties and without the issue having been raised before the FERC on rehearing.

It is the affirmance of the FERC's overreaching its jurisdiction by establishing third party protest procedures, the affirmance of the FERC's revocation of the presumption that area rate clauses provide contractual authority to collect just and reasonable rates of general applicability, and the court of appeals' reaching of an issue not properly before it, which constitute the basis for this petition for a writ of certiorari.

REASONS FOR GRANTING A WRIT

I.

Congress established in Title I of the NGPA a natural gas pricing scheme designed to reduce regulatory jurisdiction and increase producer revenues, thereby eliciting new supplies of natural gas through additional producer capital and incentive prices.[22] Maximum lawful ceiling prices, with specified escalation formulas, were statutorily prescribed to ensure predictable natural gas prices. The FERC retains wellhead pricing authority only to the extent that it can prescribe *higher* just and reasonable rates than those established in the NGPA; it cannot, however, lower such prices. Additionally, the FERC's certificate jurisdiction is reduced. These measures were all deemed necessary so that all facets of the natural gas industry could slowly

[22] 15 U.S.C. §§ 3301-3320.

adjust to the partial deregulation of natural gas to be effected by the NGPA in 1985.

Integral to this pricing scheme is that producers collect NGPA prices.[23] Recognizing that NGPA implementation could be fatally undermined by protracted litigation concerning the justness and reasonableness of the statutory maximum lawful ceiling prices, Congress declared that NGPA prices are to be deemed just and reasonable for purposes of the Gas Act.[24] Thus, Congress sought to ensure that the NGPA rates, carefully balanced to protect

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[23]The three major studies undertaken to apprise the Congress of the economic impact of the NGPA, both in terms of consumer costs and enhanced production, were based on the assumption that producers would receive NGPA prices. *See* An Evaluation of Natural Gas Pricing Proposals, Analysis Memorandum No. AM/IA-7902, DOE/EIA, June 14, 1978; STAFF OF SUBCOMM. ON ENERGY AND POWER, HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 95TH CONG., 2D SESS. (Comm. Print 62, 1978); The Natural Gas Compromise, Natural Resources and Commerce Division, Congressional Budget Office, August 2, 1978. The evidence was summarized by Senator Domenici testifying before the FERC:

> Certainly every statistical study done on the Natural Gas Bill assumed that interstate contracts would, by and large, escalate to the ceiling price. The numbers always assumed one hundred percent would, although they understood that this was a bit of an overstatement. They would certainly have acted differently if they thought that very few contracts could rise automatically.

Statement of Senator Pete V. Domenici, Docket No. RM79-22 (February 27, 1979). R. 1, 14.

[24]Timely implementation of this legislative approach is essential because of Congress' goal of bringing natural gas prices to market clearing levels by 1985 when many categories of natural gas are deregulated under the Act. Failure to implement the NGPA will impair this objective and will exacerbate the difficulties inherent in moving from a controlled to a deregulated industry.

public and producer interests, would be available to producers as established without interference or abatement. The FERC was delegated the responsibility to implement the Act, but its discretion to do so was carefully delimited by the declaration that NGPA prices are to be deemed just and reasonable.

The FERC has not only failed its essential responsibility to implement Title I of the NGPA as enacted, it has eviscerated it. Where Congress sought price certainty, the FERC has introduced a destructive and unnecessary uncertainty. Where Congress sought to ensure that NGPA prices reach producers without delay or abatement, the FERC has established procedures which guarantee that producers will either not collect NGPA prices or collect them free of refund obligations only upon the exhaustion of protracted agency proceedings and litigation. The FERC's orders have essentially returned producers to the *status quo ante;* exploration and production is retarded because the collection of the NGPA rates that would make such activity economically feasible is uncertain and NGPA revenues cannot be productively utilized due to the possibility that when collected they may be required to be refunded. Likewise, consumers are penalized because they are paying NGPA prices but are denied the full measure of the enhanced production Congress intended.

The FERC's orders transgress the controlling precedents of this Court, and violate the specific command of the Congress. The establishment of procedures whereby third parties may contest the parties' mutual assertion of contractual authority to charge and collect NGPA rates pursuant to an area rate clause exceeds the limits of the FERC's jurisdiction under the *Mobile-Sierra* doctrine. The FERC's revocation of the presumption that area rate clauses conclusively provide contractual authority to

charge and collect just and reasonable rates violates Section 601(b)(1)(A) of the NGPA. Through these two actions, the FERC, apparently dissatisfied with the congressional plan, has taken unto itself more regulatory authority than it had prior to the passage of the NGPA. It has exercised this self-endowed jurisdiction to frustrate implementation of the NGPA, flaunt the congressional intent behind its passage, and undermine indirectly the statutory prices it cannot directly assail.

The FERC's orders have denied the price certainty that is at the very heart of Title I of the NGPA. These orders have lead to the protest of nearly every interstate gas purchase contract. In the three years since the enactment of the NGPA, the FERC has not resolved a *single* protest. The resultant uncertainty is the very evil of the Gas Act scheme of pricing regulation that Congress sought to eliminate. And it is this uncertainty which creates the urgency for this Court's review. Because it is the very fact of uncertainty which undermines the goals of the NGPA, it is imperative that certainty be restored. Only this Court can resolve that issue. For until this Court acts on the issue, the situation remains fluid and unresolved, thereby fostering a price uncertainty that may well nullify the congressional objectives of NGPA Title I. Granting of Petitioners' writ is of fundamental importance for the additional reason that the FERC's actions assail and reject the significant role that this Court has determined private contracts play in the regulated natural gas industry.

II.

The benchmark against which the FERC's action, and the Fifth Circuit's affirmance, must be measured is the series of this Court's decisions known as the *Mobile-Sierra*

doctrine. The first decision of this Court underlying that doctrine was rendered in *United Gas Pipeline Co. v. Mobile Gas Service Corp.*[25] The issue before the Court was whether a natural gas company could unilaterally change the price specified in a bilateral contract by filing a new rate schedule with the Federal Power Commission. United contended that such action was authorized by the Gas Act, providing that the new rate was just and reasonable. The Court disagreed.

The Court prefaced its analysis by noting the unique regulatory structure of the Gas Act. The Gas Act provides that executory gas contracts must be filed with the FERC; the FERC is thereafter empowered to set aside and modify any rate which it determines to be "unjust, unreasonable, unduly discriminating or preferential."[26] Under this legislative design, the FERC was given review and veto authority, and the public interest was protected by the requirement that natural gas rates must be just and reasonable. This statutory scheme, the Court observed, was in marked contrast to controlled price legislation such as the Interstate Commerce Act which, by requiring all shipping rates to be uniform, precludes private rate agreements. Thus, the Court concluded that the Gas Act "evinces no purpose to abrogate private rate contracts" and to the contrary "expressly recognizes that rates to particular customers may be set by individual contracts."[27]

Since the "initial rate-making and rate-changing powers of natural gas companies remain undefined and unaffected by the Act," the Court held "[t]he obvious implication is that, except as limited by the Act, the rate-making

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[25] 350 U.S. 332 (1956).

[26] 15 U.S.C. §§ 717c(c), 717c(d).

[27] 350 U.S. at 338.

powers of natural gas companies were to be no different from those they would possess in the absence of the Act."[28] Under general principles of contract law, one party to a contract cannot unilaterally increase the contract price unless the contract authorizes the increase. Thus, a party cannot unilaterally increase the price under a natural gas sales contract absent contractual authority. Since United, the regulated party, lacked contractual authority to file unilaterally a new rate schedule for a higher rate, the Court held that United's filing was a nullity. If, however, a party had a contract clause authorizing unilateral rate increase filings, the FERC could override that contractual pricing provision only to the extent necessary to ensure that the prohibition under the Gas Act against charging and collection of unjust and unreasonable rates was not transgressed.

The second decision rendered by this Court which underlies the *Mobile-Sierra* doctrine was *FPC v. Sierra Pacific Power Co.*[29] There, the vendor of electric power to Sierra Pacific Power Company attempted to increase unilaterally the rate by filing a new rate schedule with the FPC. Over the objections of Sierra, the FPC approved the new rate because it was found to be just and reasonable. Following its reasoning in *Mobile,* the Court held that neither the unilateral rate filing, unauthorized by the contract, nor the FPC's finding that the new rate was just and reasonable was effective to change the contract price, since there was no showing that the contract price already in effect was unjust and unreasonable.

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[28] *Id.* at 343.

[29] 350 U.S. 348 (1956). Although the case arose under the Federal Power Act, the Court found the operative provisions to be identical to those of the Gas Act.

The *Mobile* and *Sierra* decisions were reiterated and clarified in *United Gas Pipeline Company v. Memphis Light, Gas & Water Division.* [30] In that case, United filed a new rate schedule based upon contracts that provided the price was to be "Seller's Rate Schedule, or any effective superceding rate schedule." The Court held that, pursuant to this term of the contracts, United was free to change its rates unilaterally subject only to the limitations of the Gas Act. With respect to the interplay of the Gas Act, the Court observed:

> United, like the seller of an unregulated commodity, has the right in the first instance to change its rates as it will, unless it has undertaken by contract not to do so. The Act comes into play as to rate changes only in (1) imposing upon the seller the procedural requirement of filing timely notice of change, (2) giving the Commission authority to review such changes, and (3) authorizing the Commission . . . to require the posting of a refund bond pending a determination of the lawfulness of the rates charged. [31]

Thus, under the *Mobile-Sierra* doctrine, changes in natural gas prices must follow a two step sequential process. First, the contract must authorize the price increase. Second, if the parties agree as to contractual authority, the price must be just and reasonable. If one party to the contract disputes the contractual authority of the other party to increase the price, the FERC must resolve that controversy to determine whether it has jurisdiction to accept the new rate schedule. But the FERC's authority to resolve

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[30] 358 U.S. 103 (1958).

[31] *Id.* at 113.

the contractual dispute between the parties is only ancillary to its jurisdiction to determine whether the price applied for is just and reasonable.

The corollary to the *Mobile-Sierra* doctrine is that where the parties to the contract are in agreement and mutually assert that contractual authority to increase the contract price exists, the FERC's jurisdiction is limited solely to determining whether the proposed rate is just and reasonable. Absent dispute among the parties, the FERC has no authority to interpret contractual provisions and certainly no right to invite strangers to the contract to contest the mutual interpretation ascribed by the parties. [32]

Congress engrafted the preservation of private contract rights embodied in the Gas Act, and recognized under the *Mobile-Sierra* doctrine, onto the NGPA. Section 101(b)(9) of the NGPA expressly provides that nothing in the Act is intended to supersede private contract arrangements except to the extent that the contract would result in a price in excess of a maximum lawful price. [33] Thus, FERC's discretion as to private contractual rights is at least as circumscribed under the NGPA as it was under the Gas Act.

By establishing third-party protest procedures, the FERC violates those elements of the *Mobile-Sierra* doctrine engrafted onto the NGPA by Section 101(b)(9). Congress has declared in Section 601(b)(1)(A) of the

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[32]Indeed, the FERC itself has recognized this limitations upon its jurisdiction. In *Gulf States Utilities Company v. FPC*, ____ F.P.C. _____, 9 Fed. Pwr. Serv. 5-100 (1976), the Commission Staff disputed the agreement of the parties to a contract as to the appropriate interpretation of the provisions of that contract. The Commission held that "since there is no disagreement between the parties as to the meaning of the [contract] there is no justiciable issue pending before this Commission." *Id.* at 5-118.

[33]15 U.S.C. § 3311(b)(9).

NGPA that NGPA prices are to be deemed to be just and reasonable for purposes of the Gas Act. [34] Consequently, where the parties to a contract are in agreement that their area rate clause provides contractual authority to charge NGPA rates, under *Mobile-Sierra* the FERC is obligated to give effect to the parties' contract and has no jurisdiction to interject itself or other third parties into contract interpretation.

Indeed, third parties lack fundamental standing to protest the collection of NGPA prices. As noted by the Court in *Mobile,* federal regulation of the natural gas industry balances the correlative interests of natural gas consumers and natural gas producers. Consumers are protected by the requirement that natural gas prices be just and reasonable; producers and pipelines are protected by the right to establish prices by contract in the first instance. In enacting the NGPA, Congress set by statute the prices that are to be considered just and reasonable; hence the public's protection is complete and conclusive so long as a rate not in excess of the maximum lawful price is collected. And in the instant case, the FERC makes no claim that area rate clauses are being utilized to collect a price in excess of the applicable maximum lawful price. Indeed, it could not, for an area rate clause by its very nature authorizes only payments and collection of the maximum lawful price. The consequence is that third parties are not aggrieved by a producer's collection of NGPA prices; therefore, the FERC's third party protest procedures create standing in fact where none exists in law.

In the case at bar, the contracting parties have exercised their contractual right to set their price by mutual agree-

[34] 15 U.S.C. § 3341(b)(1)(A).

ment by executing area rate clauses and mutually interpreting their area rate clauses as providing contractual authority to charge and collect NGPA prices. Since the prices agreed to by the parties do not exceed applicable NGPA ceiling prices, which Congress has declared, and the FERC has agreed,[35] are just and reasonable, there is nothing for any nonparty to protest or challenge. By violating the *Mobile-Sierra* doctrine, the FERC abrogates the right of natural gas companies to govern their relationship by private contract and offers its staff and other nonparties a unique and impermissible opportunity to delay or deny the recovery of NGPA rates by natural gas producers.

III.

In addition to violating the controlling precedents of this Court, the FERC has violated the command of Congress that NGPA rates be treated the same as lawful rates prescribed under the Gas Act. Prior to enactment of the NGPA, the FERC accorded a presumption that area rate clauses provided sufficient contractual authority to collect any just and reasonable rate of general applicability. In the orders on review, the FERC has repealed this presumption, thus creating an improper distinction between just and reasonable rates prescribed under the Gas Act and just and reasonable rates established by Congress. The prejudicial treatment accorded NGPA rates contravenes the clear requirement of the NGPA and thus must be reversed.

After the advent of producer price regulation with this Court's decision in *Phillips Petroleum Company v.*

[35] R. 1061.

Wisconsin,[36] the FERC embarked upon a ratemaking approach to establish just and reasonable wellhead prices for specific geographic areas.[37] Area rate clauses as permitted under the FERC's regulations provided producers the contractual authority to collect just and reasonable area ceiling prices which might thereafter be established and applicable to the sale in question.[38] This allowed them to enter into long-term contracts with interstate pipeline with the assurance that they would be allowed to collect maximum lawful prices for their gas.

In 1974, the FPC abandoned the area-wide ratemaking approach and prescribed a just and reasonable ceiling price of general applicability on a national basis.[39] Consistent with the underlying purpose of area rate clauses, they were considered by the FERC to provide contractual authority to collect nationwide rates since the national ceiling price was no less just and reasonable than the area rate.

In this regulatory environment Congress enacted the NGPA and declared that the ceiling prices of general applicability established thereby were to be deemed just and

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[36]347 U.S. 672 (1954).

[37]*See* Opinion No. 468, 34 F.P.C. 159, *modified*, Opinion No. 468-A, 34 F.P.C. 1068 (1965), *aff'd*, *In re* Permian Area Rate Cases, 390 U.S. 747 (1968), *implemented*, 40 F.P.C. 242 (1968), *aff'd*, Phillips Petroleum Co. v. FPC, 405 F.2d 6 (10th Cir. 1969).

[38]As discussed at note 6, *supra*, area rate clauses were permitted because the Commission found that it was in the public interest to allow producers, normally under long-term contracts, to receive price increases based upon changes in the applicable just and reasonable rate.

[39]*See* Opinion No. 699-H, 52 F.P.C. 1604 (1974), *aff'd sub nom* Shell Oil Co. v. FPC, 520 F.2d 1061 (1975), *rehearing denied*, 525 F.2d 1261 (5th Cir.), *cert. denied*, 426 U.S. 941 (1976).

reasonable for purposes of the Gas Act.[40] As recognized by the FERC,[41] NGPA prices are the very types of prices which have historically triggered area rate clauses. Nevertheless, the FERC has removed the well-established presumption that area rate clauses constitute contractual authority to collect applicable just and reasonable ceiling prices. Instead, it has imposed upon producers the burden of proving specific contractual authority to collect just and reasonable NGPA ceiling prices under an area rate clause whenever a purchasing pipeline raises a protest.

By refusing to afford the presumption of contractual authority to area rate clauses where NGPA rates are concerned, the FERC has in effect declared that there are two types of just and reasonable prices: those established by it pursuant to a general congressional delegation of power, and those established by Congress under the NGPA. This attempted bifurcation of prices is unsustainable and is the very action Congress sought to prevent by the adoption of Section 601(b)(1)(A). The FERC has not contested the fact that NGPA prices must be deemed to be just and reasonable for purposes of the Gas Act; indeed, it expressly concedes the point. [42] The FERC also concedes that area rate clauses in the past have universally operated as contractual authority to collect just and reasonable prices

[40] 15 U.S.C. § 3431(b)(1)(A).

[41] See note 11 *supra*.

[42] In Order No. 23, the FERC stated that it:

> . . . fully accepts the view that maximum lawful ceiling prices prescribed under the Natural Gas Policy Act are "just and reasonable" prices for purposes of section 4 and 5 of the Natural Gas Act. The Congress has clearly said so in section 601 of the Natural Gas Policy Act. Moreover, the Commission does not (nor could it properly) object to such prices on the basis that they are "too high" or that they are not adequately "cost-related or justified." The Congress

of general applicability, [43] which the NGPA prices clearly are. Moreover, the FERC cannot point to a single instance over the twelve years antedating the NGPA in which it has entertained a pipeline's protest of the contractual authority of a producer to charge and collect just and reasonable rates pursuant to a validly executed area rate clause.

The potential absurdity of the FERC's position is highlighted by consideration of the Commission's residual authority under the NGPA to establish higher just and reasonable rates than set forth in the Act.[44] If a pipeline protests the contractual sufficiency of the area rate clause to authorize the collection of the statutory rate, the producer is required to prove the existence of contractual authority. But if the FERC prescribes a higher just and reasonable rate, the area rate clause would be presumed to provide contractual authority to collect the higher rate.

The revocation of the presumption of contractual authority further reveals the FERC's attempt to subvert the integrity of the NGPA Title I prices since it creates a substantial impediment to the collection of NGPA rates by producers if a pipeline protests the contractual authority of an area rate clase. Thus, by altering a well-established presumption, the FERC violates an express command of Congress and further manifests its intent to undermine the substantive implementation of the NGPA.

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has struck the balance between consumer and producer interests; reserved to this Commission is only the task of administration and the authority to prescribe higher price ceiling in certain circumstances.

R. 1061.

[43] R. 1086. See note 11 *supra*.

[44] *See, e.g.*, 15 U.S.C. § 3314(b)(2).

IV.

In addition to the issues raised and briefed by the parties, the court of appeals *sua sponte* addressed the operation of definite price escalator clauses and favored nation clauses in intrastate contracts under the NGPA. [45] Many such clauses, as the court observed, anticipated the day federal price control would be extended to the intrastate market and attempt to provide for price escalation to federally established ceiling rates in the event of such price regulation.

The operation of legislative clauses in intrastate contracts was never a direct issue in the FERC proceeding or the proceedings below. As such, the issue was not briefed to the court of appeals. Indeed, because of the lack of any record on point, it is impossible to ascertain the intended breadth of the court's statement. Moreover, the statement was wholly unnecessary to the resolution of the issues which were presented to the court of appeals.

Most importantly, because the issue was not presented in the record, particularly on rehearing before the FERC, it was not a matter before the court of appeals under Section 506 of the NGPA. [46] This is an instance falling clearly within the policy of that section; as no party, including the FERC, had an opportunity to address the issue, no party can define what is meant. Thus the issue is not ripe for appellate review.

In view of the confusion created by the court's statement on this issue, Petitioners filed a petition for rehearing with the court of appeals. Petitioners urged the court of appeals to delete the statement as unnecessary to its decision.

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[45] 645 F.2d at 376 n. 32.

[46] 15 U.S.C. § 3416.

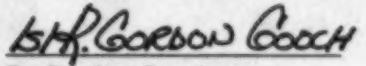
Although final action by the court of appeals may moot the issue, Petitioners raise with this Court the propriety of the court of appeals' *sua sponte* discussing an extraneous issue which under the controlling statutory review provisions was not within its jurisdiction and which resultantly was neither raised, considered nor briefed by the parties.

CONCLUSION

The dilemma confronting a producer is both real and resolvable only by this Court. Virtually all producer contracts containing area rate clauses have been protested, mostly by third parties. No matter how long the litigation goes on, the possibility of just one inconsistent decision results in confusion and will effectively maintain all rates as subject to refund no matter what the course of future FERC decisions on individual protests and subsequent decisions by the courts of appeal. This confusion ultimately can be resolved only by this Court. But, by leaving the question open until a later date, the uncertainty which presently surrounds NGPA pricing will continue and defeat those very purposes for which the Act was enacted.

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,



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Supplemental Brief

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No. 81-340

IN THE
Supreme Court of the United States
OCTOBER TERM, 1981

PENNZOIL COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION
Respondent.

MEMORANDUM OF PENNZOIL COMPANY, *et al.*, REGARDING THE WITHDRAWAL OF A CERTAIN ISSUE PRESERVED FOR REVIEW IN THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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TABLE OF CONTENTS

Page

Memorandum of Pennzoil Company 1

Appendix A Petition for Rehearing of Petitioners and Conditional Request for Extension of Time for Filing Suggestion for Rehearing *En Banc* 1a

Appendix B Petition for Rehearing of Phillips Petroleum Company 7a

Appendix C Order Denying Petition's For Rehearing 17a

TABLE OF CITATION'S

Natural Gas Policy Act of 1978, 15 U.S.C. § 3416 ..... 1, 2

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MEMORANDUM OF PENNZOIL COMPANY, *et al.*, REGARDING THE WITHDRAWAL OF A CERTAIN ISSUE PRESERVED FOR REVIEW IN THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

On August 18, 1981, Petitioners filed with this Court a Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit. Therein, Petitioners raised as an issue for this Court's review the propriety of the court of appeals *sua sponte* deciding a question which was foreclosed to it under Section 506 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3416.[1] This issue appears as number 3 of the questions presented for review.

It was noted in the petition that Petitioners[2] and Phillips Petroleum Company[3] had filed petitions for rehearing

[1]Petition at i.

[2]Appendix A.

[3]Appendix B.

with the court of appeals. Both petitions concerned the same issue, asserting that the court of appeals improperly addressed and decided an issue that was not raised in petitions for rehearing to the FERC, not briefed before the court of appeals and not germane to the decision rendered by court.[4] Petitioners requested that the court of appeals either simply delete the discussion of this issue from the decision since it was in no manner germane to the court's decision or grant rehearing so that the issue could be briefed. Petitioners further noted in the petition for certiorari that they had urged the court of appeals to delete the language as unnecessary to its decision[5] and that action by the court of appeals could moot the issue.[6]

On August 21, 1981, the United States Court of Appeals for the Fifth Circuit entered, per curiam, an order on the petitions for rehearing.[7] Granting the relief requested by Petitioners, the court deleted the objectionable paragraph from footnote 32 of the opinion, 645 F.2d 360 at 377. The court also made minor conforming changes to the text of the opinion. The court then denied the petitions for rehearing.

Based upon the August 21, 1981, order of the court of appeals, Petitioners hereby withdraw from those issues identified for review issue number 3, involving the propriety of the court of appeals deciding a question foreclosed to it under Section 506 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3416. Encompassed within this withdrawal is the related text appearing at roman numeral

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[4]Petition at 25.

[5]*Id.*

[6]*Id.* at 26.

[7]Appendix C.

IV, pages 25 and 26. The August 21, 1981, order of the court of appeals has resolved this issue, which although of substantive importance was not germane to the court of appeal's decision, and has rendered it moot.

Respectfully submitted,

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APPENDIX A

UNITED STATED COURT OF APPEALS FOR THE FIFTH CIRCUIT

Pennzoil Company, *et al.*, *Petitioners,*	)	
v.	)	Nos. 79-1247 79-1602
Federal Energy Regulatory Commission, *Respondent.*	)	

PETITION FOR REHEARING OF PETITIONERS AND CONDITIONAL REQUEST FOR EXTENSION OF TIME FOR FILING SUGGESTION FOR REHEARING *EN BANC*

Pursuant to Rule 40 of the Federal Rules of Appellate Procedure, the undersigned Petitioners hereby petition for rehearing of the Court's opinion entered May 20, 1981 in the above-referenced cases. In the event any other party is granted an extention of time to petition for rehearing *en banc,* the undersigned Petitioners request that they likewise be granted any such extention to bring any additional matters to the attention of the Court.

INTRODUCTION

These cases involve review of orders entered by the Federal Energy Regulatory Commission (FERC) in Docket No. RM79-22; these orders have been referred to throughout these cases as the Order No. 23 series of orders.[1] The issues presented in these cases focused on two major areas. The first was the propriety of the FERC's rules establishing general guidelines for construing area

[1]These Orders are set out at Slip Op. 7342 n.3 of the Court's May 20, 1981 opinion.

rate clauses in regard to the question of whether they constituted sufficient contractual support to authorize producers to charge and collect prices established pursuant to the Natural Gas Policy Act of 1978 (NGPA).[2] The second issue presented involved the validity of the procedures established by the FERC to adjudicate disputes over the contractual sufficiency of area rate clauses to collect NGPA rates.

In its discussion of the limitations imposed by the NGPA on the operation of escalation clauses, the Court set out generally the manner in which Section 105 of the NGPA imposed pricing limitations on existing intrastate contracts. In the course of that discussion, the Court footnoted the operation of definite price escalator clauses and favored nations clauses in those contracts.[3] However, the second paragraph became more specific. The Court there stated:

> Some foresighted intrastate producers included legislative rate clauses in their contracts against the day Congress extended federal price controls to the intrastate market. This clause will not escalate the § 105(b)(1) contract's price to the § 102 price. The maximum lawful § 105(b)(1) price is the *lower* of the current contract price or the § 102 price. Absent some other escalation mechanism or ability to qualify under some other pricing category, the current unescalated price is the maximum lawful price. In other words, the escalation provision is, in effect, looking to itself, and cannot be used to bootstrap the price any higher. The legislative rate clauses, however,

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[2]15 U.S.C. § 3301, *et seq.*

[3]Slip op. 7355 n.32.

would suffice for collection of the maximum lawful price of some other category if the gas under the contract qualified for that category.

Petitioners joining herein respectfully urge that the panel, or alternatively, the Court *en banc*, grant rehearing and delete that paragraph.

ARGUMENT

I. The Court Should Delete The Paragraph.

The operation of legislative clauses in intrastate contracts was never a direct issue in the instant proceeding. Review of the record before both the FERC and this Court reveals *no* instance in which the actual operation of those clauses was argued. Indeed, because of the lack of any record on point, it is impossible to quantify precisely the type of clause which the Court intended to address.

There are within intrastate contracts many variants of "area rate clause" type language in addition to other escalation provisions. These clauses have previously operated to allow producers to collect higher prices under their contracts. With the enactment of the NGPA, litigation sometimes ensued as to the permissible operation of these clauses.

The problem which arises out of the Court's footnote is multifold. First, it was never a point of argument or contention, so it is impossible for the parties to ascertain the intended breadth of the statement. As a result, it could severely prejudice existing litigations. Parties will argue in different courts in which controversies over the operation of various variants of area rate clause language in intrastate contracts are pending over their own views as to the precise scope of what this Court intended. Because no

predicate exists in the record for the particular statement, any such contention could be based only upon random conjecture. And since these proceedings would generally not be cases within the appellate jurisdiction of this Court, there would be no opportunity for this Court to define further exactly what it meant by its statement.

Second, the paragraph is wholly unnecessary to the resolution of the issues which were presented to this Court. Its deletion will in no manner affect this Court's decision. Yet at the same time, it severely prejudices producers selling, and purchasers buying, natural gas under existing intrastate contracts. Because it is impossible for the parties to define what was intended within the scope of the Court's statement, parties must determine whether to continue collections under area rate clause language that may arguably be within the proscription of the Court and risk possible future criminal sanctions for violation of the maximum lawful pricing limitations. Alternatively, they must cease collections and refund past amounts if any argument exists that the Court's proscription may apply when it may ultimately be thereafter determined that it did not.

Third, the Court's resolution of the issue is wholly inconsistent with the Court's determination that resolution of contract issues should be left to state contract law. The Court has stated repeatedly, including in this opinion, that there is no federal contract.[4] Yet this Court, in the paragraph complained of, has proposed and promulgated in one action a new federal rule of contract law of undefined scope.

Fourth, because the issue was not presented in the record, particularly on rehearing before the Commission,

[4] *E.g.*, slip op. 7363-71.

it was not a matter before the Court under Section 506 of the NGPA.[5] This is an instance falling clearly within the policy of that section; as no party, including the Commission, has had opportunity to address the issue, no party can define what is meant. But, inasmuch as it was not a matter addressed on rehearing, this Court did not have the jurisdiction to decide the issue.

In short, since the parties, including the Commission, never addressed the issue, the parties are left wholly without reference point as to the breadth or scope of the intended proscription. Further, having had no opportunity to address the issue, the Court had no basis upon which to judge the merits. Finally, the Court has severely prejudiced parties, both as to their day-to-day operations as they attempt to comply with the law and as to other pending cases in which the issue in its various aspects is being litigated.

II. In the Alternative, Rehearing Should Be Granted To Allow The Issue To Be Briefed.

If the Court should determine not to delete the paragraph without further hearing, then the parties should be allowed to brief the issue. Deciding a major issue of contract law without any opportunity to address the issue raises serious questions as to whether the parties have been afforded constitutional guarantees of due process. Further, having had no benefit of briefing, the Court has been denied a full airing of the issue prior to its decision.

Therefore, the Court, if it does not summarily delete the complained of paragraph, should schedule briefing on the matter.

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[5] 15 U.S.C. § 3416.

III. If The Court Extends The Date For Filing Petitions For Rehearing En Banc, Petitioners Should Equally Be Granted The Benefit of Such Extension.

On May 28, 1981, the FERC applied for an extension of time within which to file a petition for rehearing *en banc* with this Court. In the event this Court grants such motion for an extension of time, the undersigned Petitioners request that they be granted such extension also.

WHEREFORE, the undersigned Petitioners respectfully request rehearing be granted. Further, if the Court grants any other party's motion for an extension of time for filing a petition for rehearing *en banc*, Petitioners request that they be granted such extension also.

Respectfully submitted

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DATED: June 3, 1981

APPENDIX B

IN THE
United States Court of Appeals
FOR THE FIFTH CIRCUIT

Nos. 79-1247 79-1602

PENNZOIL COMPANY, *et al.*,
Petitioners,

versus

FEDERAL ENERGY REGULATORY COMMISSION
Respondent.

ON PETITION FOR REVIEW OF ORDERS OF THE FEDERAL ENERGY REGULATORY COMMISSION

PETITION FOR REHEARING OF PHILLIPS PETROLEUM COMPANY

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

Pennzoil Company, *et al.*, *Petitioners,*	)	
v.	)	Nos. 79-1247, 79-1602, et al.
Federal Energy Regulatory Commission, *Respondent*	)	

PETITION FOR REHEARING OF PHILLIPS PETROLEUM COMPANY

PHILLIPS PETROLEUM COMPANY (Phillips) petitions for a limited rehearing of the Court's opinion issued in the captioned case on May 20, 1981 pursuant to Rule 40 of the Federal Rules of Appellate Procedure.

I.

The Court's May 20 1981 opinion reflects detailed analysis of the Natural Gas Policy Act of 1978 (NGPA) and contract pricing provisions used in interstate and intrastate gas sales contracts in support of the Court's general conclusion that the NGPA neither requires nor precludes area rate clauses from escalating the interstate contract price to the maximum lawful NGPA prices. However, Section III. B of the Court's opinion contains certain statements with respect to intrastate contracts and the interpretation of Section 105(b) of the NGPA which are both dicta unnecessary to the result reached in the Court's opinion and which are erroneous in certain respects. Phillips is concerned that the Court's comments

may prejudice both litigation and contract negotiations regarding intrastate gas sales. Phillips respectfully requests that the Court withdraw or correct its statements regarding intrastate gas contract prices in the particulars discussed below.

II.

The statements of concern to Phillips are included in footnote 32 of the opinion and the text accompanying footnote 32 in Section III.B. The footnote concerns the rules applicable to existing intrastate contract gas subject to Section 105(b)(1) of the NGPA. The Court correctly states the rules applicable under Section 105(b)(1) insofar as they relate to amounts which can be lawfully collected; but the Court fails to draw a distinction between contract prices which may be set under the terms of existing intrastate contracts and prices which may be lawfully collected. That distinction is crucial under existing intrastate contracts subject to Section 105(b)(1) of the NGPA.

The text accompanying footnote 32 states that:

> "If the contract has an escalation provision, definite or indefinite, it may increase the contract price up to but not in excess of the Section 102 price, and then can escalate only at the statutory inflation and real growth adjustment rates." (Slip Opinion at 7355)

The Court's statement is an accurate summary of the price controls established under Section 105(b)(1); but those price controls do not preclude increases in contract prices (as opposed to collections) to prices higher than those which can then be lawfully collected. Only Section 105(b)(3) limits price increases resulting from indefinite

price escalator clauses, and those limitations apply only on and after January 1985. Further, Section 101(b)(9) of the NGPA states that maximum lawful prices under the NGPA do not "supersede *or nullify* the effectiveness of the price established" under gas sales contracts. In enacting the NGPA, Congress intended to establish a system of price controls for natural gas, but did not intend to limit the freedom of parties to contracts to redetermine prices under the terms of existing contracts except in the specific instances outlined in Sections 105(b)(3) and 313 of the NGPA. The Statement of Representative John D. Dingell on Filing of the Natural Gas Conference Report contains a joint statement of the House managers on the interpretation of the NGPA [124 Cong. Rec. H12773, 775-6 (Oct. 12, 1978)]. The joint statement discusses this aspect of Section 105(b) as follows:

> "Under Section 105(b) indefinite price escalators contained in an existing intrastate contract on date of enactment are to be given effect up to the limitations set forth in Sections 105(b)(1) and 105(b)(2)."

The Congressional intent to allow operation of indefinite price escalator clauses in intrastate contracts according to their terms subject to the stated price collection limits is clear. In this respect, the NGPA is similar to the Natural Gas Act of 1938; parties are free to contract, subject to regulatory power to limit prices collected. *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 76 S.Ct. 373, 100 L.Ed. 373 (1956); *United Gas Pipe Line Co.* v. *Memphis Gas, Light & Water Div.*, 358 U.S. 103, 79 S.Ct. 194, 3 L.Ed.2d 153 (1958).

A few examples will illustrate the importance of the distinction between contract price escalations pursuant to

the terms of contracts and amounts which may be collected. The States of Kansas and Oklahoma have adopted statutes which limit prices which may be paid for gas not subject to NGPA Sections 102, 103, 107 or 108 generally to the somewhat lower price established under NGPA Section 109. Kansas Stat. Annot. § 55-1401, et seq.; 52 Okla. Stat. §§ 260.1-260.13. There are numerous existing intrastate contracts subject to the Kansas and Oklahoma statutory price limits which call for only annual price redeterminations or escalations based on the highest price paid or the average of the three highest prices paid in a specified area as of the time of price redetermination. Price redeterminations under contracts of that type will generally be made at the NGPA Section 102 or 108 price in effect for the month in which the redetermination occurs. Producers then limit their actual collections to the NGPA Section 109 price, but assert contract authority for the monthly inflation adjustment increases to the NGPA Section 109 price because the redetermined contract price is higher than the prices which may be lawfully collected. Producers assert that they are not required under the Kansas and Oklahoma statutes or under the NGPA to limit actual redeterminations to the NGPA Section 109 rate in effect for the month in which the price redetermination occurs. The court's dicta in Footnote 32 may unduly prejudice litigation now pending with respect to these issues. See, e.g., *Kansas Power & Light Co.*, Kansas Corporation Commission Docket No. 126,236-U, Order issued May 12, 1981; *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, Supreme Court of Kansas No. 80-52677 (appeal pending).

In states where no state natural gas price control statutes have been enacted, it is permissible to escalate contract prices to the stripper well rate established under Section

108 of the NGPA if the favored nations clause, price redetermination clause, or area or nationwide rate clause contemplates that result. Prices established under Section 108 of the NGPA were not included in the indefinite price escalation clause restriction of Section 313 of the NGPA. Again, annual price redeterminations at the Section 108 price for the month in which the determination occurs can provide contractual authority for collection of monthly increases permitted under Section 102 and Section 105(b)(1) where the price paid might otherwise remain constant throughout the price redetermination period.

The NGPA does not forbid operation of area or nationwide rate clauses or legislative rate clauses in existing intrastate contracts. In the free market for intrastate gas sales in existence prior to enactment of the NGPA, parties were aware that dates of discovery or drilling do not determine the value of gas to consumers and that producers reasonably expect current market values in exchange for long-term dedications in gas sales contracts. In many cases producers and purchasers did agree that the price payable under an existing intrastate contract should always equal the highest generally applicable rate allowed for sales of gas in interstate commerce. As an example, parties contracting immediately prior to enactment of the NGPA might have provided in an existing intrastate contract that the price payable should be equal to stripper well prices established under Section 108 of the NGPA, even as to gas not qualifying as stripper well gas. In such an event, the contract price would be equal to the stripper price each month, but collections would be limited to the price established under Section 102 of the NGPA.

The last paragraph of footnote 32 seems to preclude this result. The Court states that:

> "Some foresighted intrastate producers included legislative rate clauses in their contracts against the day Congress extended federal price control to the intrastate market. This clause will not escalate the § 105(b)(1) contract's price to the § 102 price. The maximum § 105(b)(1) price is the lower of the current contract price or the § 102 price. Absent some other escalation mechanism or ability to qualify under some other pricing category, the current unescalated price is the maximum lawful price. In other words, the escalation provision is, in effect, looking to itself, and cannot be used to bootstrap the price any higher. The legislative rate clause, however, would suffice for a collection of the maximum lawful price of some other category if the gas under the contract qualified for that category."

While the Court's quoted statements are correct if reference is made to the applicable maximum lawful price, they are not correct if reference is being made to the contract price. Without reviewing particular contracts, the Court cannot conclude that all so-called legislative rate clauses in existing intrastate contracts are of no force or effect to escalate contract prices. Such a conclusion would be rank judicial legislation contrary to the FERC's conclusion on the issue. Order No. 23 Mimeo at 54 (R.1106). If the language is clear and sufficient to escalate the price to the NGPA Section 108 rate as to NGPA Section 108 gas, how can it be ineffective as to other gas if the parties clearly so intend it?

The court's comments in Footnote 32 appear to be an effort to give some meaning and effect to the statement in the Conference Committee report to the effect that the Conferees did not intend mere establishment of NGPA

ceiling prices to trigger intrastate contract indefinite price escalator clauses [H. Rep. No. 1752, 95th Congress, 2d Sess. at 83 (1978)]. The Court notes in its opinion at Slip Opinion 7354 that that statement of the conferees was the source of much difficulty in general. Phillips submits that the Conferees' statement at page 83 is valid only to the extent that it refers to indefinite price escalator clauses which specifically require *payment* as a condition of triggering of the contract price. The Conferees' statement is not valid as to area, nationwide or legislative rate clauses, and as applied to such clauses is inconsistent with the terms of Section 105(b) and other statements in the legislative history relating to Section 105(b).

III

In considering this petition for rehearing, the Court need not decide the issues discussed in Section II above. The Court properly concluded that in all cases, the issue is one of the parties' intent. The Court further properly concluded that in the case of intrastate contracts, the FERC's determination to leave the parties to their remedies in state and federal courts having jurisdiction was appropriate. In view of these findings, the Court's discussion of intrastate contract issues footnote 32 and the text accompanying it is unnecessary to the general result reached and potentially prejudicial to intrastate producers and purchasers, both in pending litigation and in the process of contract negotiations. Phillips urges the court to clarify that its focus was on maximum lawful prices which can be paid and collected rather than on the course of establishment of contract prices under numerous existing intrastate contracts which were not before the Court. In addition, Phillips requests that the court delete from its opinion all but the first three sentences of footnote 32 in order to avoid prejudice to parties to existing intrastate contracts.

IV.

For the foregoing reasons, Phillips respectfully urges that this limited petition for rehearing be granted.

Respectfully submitted,

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June 2, 1981

CERTIFICATE OF SERVICE

I hereby certify that I have served the foregoing Petition for Rehearing upon the Federal Energy Regulatory Commision and upon all other parties to this proceeding by first class mail, postage prepaid, this 3rd day of June, 1981.

By /s/ Larry Pain
Larry Pain

Attorney for
Phillips Petroleum Company

APPENDIX C

PENNZOIL COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION
Respondent.

Nos. 79-1247, 79-1602

United States Court of Appeals,
Fifth Circuit.

Aug. 21, 1981

Petition for Review of an Order of the Federal Energy Regulatory Commission.

ON PETITIONS FOR REHEARING

Before HENDERSON, ANDERSON and SAM D. JOHNSON, Circuit Judges.

PER CURIAM:

Upon consideration of the petitions for rehearing filed by certain petitioners, we delete the following paragraph that appears in footnote 32 of the opinion, 645 F.2d 360 at 377:

> Some foresighted intrastate producers included legislative rate clauses in their contracts against the day Congress extended federal price controls to the intrastate market. This clause will not escalate the § 105(b)(1) contract's price to the § 102 price.The maximum lawful § 105(b)(1)

price is the lower of the current contract price or the § 102 price. Absent some other escalation mechanism or ability to qualify under some other pricing category, the current unescalated price is the maximum lawful price. In other words, the escalation provision is, in effect, looking to itself, and cannot be used to bootstrap the price any higher. The legislative rate clause, however, would suffice for collection of the maximum lawful price of some other category if the gas under the contract qualified for that category.

The sentence in text, 645 F.2d at 376, column 2, beginning on line 10 from the bottom of the text, is modified to read as follows:

> If the contract has an escalation provision, definite or indefinite, it may authorize collection of prices up to but not in excess of the section 102 price, and then can authorize collections only of prices equal to the statutory inflation and real growth adjustment rates.

The sentences, 645 F.2d at 377, column 1, beginning on line 2 from the top, are also modified to read as follows:

> Once the contract price is escalated to the section 102 price, the seller can receive the section 108 price only if the gas under the contract independently qualifies for section 108 pricing. If it does, then the escalation provision could authorize collection up to the section 108 price, and continue to authorize collections in accordance with the inflation and real growth adjustments provided for in section 108(a)(2).

The petitions for rehearing are DENIED.

Appendix

Office-Supreme Court, U.S.
FILED
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81-340

No. 81-

IN THE

Supreme Court of the United States

October Term, 1981

PENNZOIL COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

APPENDIX

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TABLE OF CONTENTS

Appendix A

Pennzoil Co., *et al.* v. FERC, 645 F.2d 360 (5th Cir. 1981) 1a

Appendix B

1. Interim Regulations Implementing the Natural Gas Policy Act of 1978, Docket No. RM79-3 (12/1/78) 67a

2. FERC Policy Respecting Area Rate Clauses and Indefinite Price Escalator Clauses (1/24/29) 78a

3. Order No. 23, Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act, Docket No. RM79-22 (3/13/78) 82a

4. Order on Rehearing of Order No. 23, Docket No. RM79-22 (5/11/78) 140a

5. Order No. 23-A, Amendment and Clarification of Interim Regulations Under the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act, Docket No. RM79-22 (6/12/79) 145a

6. Order No. 23-B, Adopting Final Regulations and Establishing Protest Procedures, Docket No. RM79-22 (6/21/79) 151a

7. Order on Rehearing of Order No. 23-B, Docket No. RM79-22 (8/13/79) 169a

8. Order on Rehearing of Order No. 23-A, Docket No. RM79-22 (8/13/79) 183a

Appendix C

Provisions of the Natural Gas Policy Act of 1978 .....187a

Appendix D

Provisions of the Natural Gas Act of 1938 ..... 189a

APPENDIX A

PENNZOIL COMPANY, et al., [360]
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Nos. 79-1247, 79-1602.

United States Court of Appeals,
Fifth Circuit.

May 20, 1981.

* * * * *

Before HENDERSON, ANDERSON and [365]
SAM D. JOHNSON, Circuit Judges.

SAM D. JOHNSON, Circuit Judge:

The continuing battle between producers and consumers over natural gas prices is once again before this Court. The issue in this controversy can be simply stated: May "area rate clauses"[1] in existing interstate gas purchase contracts escalate the contract price to the maximum lawful price provided in the Natural Gas Policy Act of 1978? NGPA, 15 U.S.C.A. §§ 3301-3432. In the orders on review, the Federal Energy Regulatory Commission[2] (FERC) held

[1]An "area rate clause" is a price escalation provision in a natural gas purchase and sales contract between a producer and interstate pipeline. It authorizes an escalation in the contract price whenever there is an increase in the applicable just and reasonable wellhead ceiling price for the category of gas involved.

[2]On October 1, 1977, the Commission took over the functions and responsibilities of the Federal Power Commission pursuant to the Department of Energy Organization Act § 402(a), 42 U.S.C.A. § 7172(a), and Exec. Order No. 12009, 42 Fed.Reg. 46267 (Sept. 15, 1977).

that the NGPA was no bar to that escalation and that area rate clauses as a general rule constituted sufficient contractual authority to collect NGPA ceiling prices. FERC then established a procedure whereby interstate pipelines, FERC Staff, state regulatory commissions, local distribution companies, and consumer groups could contest the contractual sufficiency of specific area rate clauses. Most producers complain that FERC did not go far enough, while consumers think that FERC went too far in providing a presumption in favor of area rate clause escalation to NGPA ceiling prices. This case raisess questions concerning the meaning of the NGPA and its interrelationship with the Natural Gas Act of 1938. NGA, 15 U.S.C.A. §§ 717-717w. It also raises a question concerning the application of the constitutional reasoning in *Erie Railroad v. Tompkins,* 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). This Court for the most part affirms and in small part sets aside and modifies the FERC orders.[3]

I. *FACTS*

A. *Escalator Clauses and the NGA*

Seven years after the Supreme Court's decision in *Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672, 74

[3]These orders, all promulgated in Docket No. RM79-22, are: Order No. 23, Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act (March 13, 1979); Order on Rehearing of Order No. 23 (May 11, 1979); Order No. 23-A, Amendment and Clarification of Interim Regulations Under the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act (June 12, 1979); Order No. 23-B, Adopting Final Regulations and Establishing Protest Procedure (June 21, 1979); Order on Rehearing of Order No. 23-B (August 6, 1979); Order on Rehearing of Order No. 23-A (August 13, 1979).

S.Ct. 672, 98 L.Ed. 1035 (1954), brought interstate gas [366]
producers within NGA rate regulation, the Federal Power Commission (FPC) in 18 C.F.R. § 154.93 prohibited the operation of certain indefinite price escalator clauses in interstate gas purchase contracts.[4] These clauses permit upward price adjustments on the occurrence of some specified triggering event. The most common of these were favored nation clauses, which generally provided that the contract price would automatically escalate to any higher prices that the pipeline purchaser, or another pipeline in a described geographic area known as the contract pricing area, paid for gas from that same defined area.[5] The FPC prospectively prohibited these clauses as contrary to the public interest because they increased the contract price by reference to events that had no economic significance to the particular sale of gas — the price one particular pro-

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[4]*See Pure Oil Co.* (FPC Opinion No. 341), 25 F.P.C. 383 (1961), *aff'd, Pure Oil Co. v. FPC,* 299 F.2d 370 (7th Cir. 1962); FPC Order No. 232, 25 F.P.C. 379, *modified,* Order No. 232-A, 25 F.P.C. 609 (1961), *petition for review dismissed, Sun Oil Co. v. FPC,* 304 F.2d 290 & 293 (5th Cir.), *cert. denied,* 371 U.S. 861, 83 S.Ct. 118, 9 L.Ed.2d 99 (1962); FPC Order No. 242, 27 F.P.C. 339 (1962), *petition for review dismissed, Hunt Oil Co. v. FPC,* 306 F.2d 878 (5th Cir. 1962). These orders were later upheld in *FPC v. Texaco, Inc.,* 377 U.S. 33, 84 S.Ct. 1105, 12 L.Ed.2d 112 (1964); *Pan Am. Petroleum Corp. v. FPC,* 352 F.2d 241 (10th Cir. 1965); *Superior Oil Co. v. FPC,* 322 F.2d 601 (9th Cir. 1963), *cert. denied,* 377 U.S. 922, 84 S.Ct. 1219, 12 L.Ed.2d 215 (1964). For a summary of the history of FPC regulation of escalation clauses, *see* 4 H. Williams & C. Meyers, Oil & Gas Law § 726.1, at 763-69 (1977).

[5]Other indefinite price escalator clauses included spiral escalation, redetermination, and renegotiation clauses. *See, In Re Permian Basin Area Rate Cases,* 390 U.S. 747, 782 n.46, 88 S.Ct. 1344, 1367-1368 n.46, 20 L.Ed.2d 312 (1968); H. Williams & C. Meyers, Manual of Terms, Oil and Gas Law 196-97 (4th ed. 1976). In contrast, a definite price escalation clause increases the price by specific amounts at definite future dates, such as a step-price or periodic increase clause. *Id.* at 138, 196-97.

ducer receives has no bearing on another producer's revenue needs or costs of production.[6]

The FPC amended section 154.93 to allow certain in- [367]
definite price escalator clauses to operate. One of these, the so-called "area rate clause," was made permissible by the addition of section 154.93(b1). Order No. 329, 36 F.P.C. 925 (1966). This allowed the use of "[p]rovisions that permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved." The permissible escalation was in the public interest since the area ceiling rate — a just and reasonable rate since it was derived by a cost-based methodology — did have economic significance to the gas in question.

To sell gas interstate, a producer must receive permission in the form of a certificate of public convenience and necessity. Under NGA, § 7, 15 U.S.C.A. § 717f, the Commission has the power to condition the grant of the certificate. This power gave the FPC the ability to further enforce its prohibition in section 154.93 by rejecting any contract executed after April 2, 1962, that contained an impermissible clause.[7] Because many contracts contained clauses that were prohibited, the Commission later adopted the practice of attaching "waivers" of section

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[6]*See In Re Permian Basin Area Rate Cases*, 390 U.S. 747, 782-83, 88 S.Ct. 1344, 1367-1368, 20 L.Ed.2d 312 (1968). The basis of FPC producer rate regulation was a carry over of the cost-based methodology for utility rate regulation. In effect, the FPC found that these escalator clauses resulted in a contract price that, because of its lack of cost justification, was unjust and unreasonable under NGA § 4, 15 U.S.C.A. § 717c.

[7]FPC Order No. 242, 27 F.P.C. 339 (1962), *voided, Texaco, Inc. v. FPC*, 317 F.2d 796 (10th Cir. 1963), *rev'd* 377 U.S. 33, 84 S.Ct. 1105, 12 L.Ed.2d 112 (1964).

154.93 to the certificates. This allowed the clauses to operate, but only as area rate clauses. The Commission thus did not have to reject these contracts and require their refiling after the parties negotiated amendments to expunge a clause that, under a literal application of the regulation, would deprive the producer of the applicable just and reasonable rate.

The FPC later abandoned its approach to producer rate regulation of prescribing rates for particular areas and instead adopted nationwide rates of general applicability.[8] Despite the literal language of section 154.93(b-1) and the language of area rate clauses that literally tracked the regulation, the FPC permitted producers and interstate pipelines to rely on area rate clauses to escalate the contract price to the national ceiling rates. The FPC also allowed area rate clauses to escalate the contract price to ceiling rates for qualifying sales of small producer gas,[9] rollover contract gas,[10] and flowing but undedicated gas.[11]

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[8]FPC Opinion No.699, 51 F.P.C. 2212 (1974), *modified,* Opinion No. 699-H, 52 F.P.C. 1604, *aff'd, Shell Oil Co. v. FPC,* 520 F.2d 1061 (5th Cir. 1975), *cert. denied,* 426 U.S. 941, 96 S.Ct. 2661, 49 L.E.d.2d 394)1976); FPC Opinion No. 749, 54 F.P.C. 3090 (1975), *reh. denied,* Opinion No. 749-C, 55 F.P.C. – (1976), *aff'd in part and set aside in part, Tenneco Oil Co. v. FERC,* 571 F.2d 834 (5th Cir.), *cert. dismissed,* 439 U.S. 801, 99 S.Ct. 43, 58 L.Ed.2d 94 (1978); FPC Opinion No. 770, 56 F.P.C. – (1976), *reh. denied,* Opinion No. 770-A, 56 F.P.C. –, *aff'd, American Public Gas Ass'n v. FPC,* 567 F.2d 1016 (D.C.Cir. 1977), *cert. denied,* 435 U.S. 907, 98 S.Ct. 1456, 55 L.Ed.2d 499 (1978).

[9]FPC Opinion No. 742, 54 F.P.C. 853, 858 (1975).

[10]FPC Opinion No. 699, 51 F.P.C. at 2274-75.

[11]*Id.*

B. *Escalator Clauses and the NGPA*

The NGPA was enacted on November 9, 1978. This statute generally adopted an incentive-based approach to rate-setting for gas production, providing substantially higher prices for "new" gas than was currently available.[12] At the same time, the NGPA provided consumer protection by maintaining lower prices on flowing gas, providing only limited future price deregulation in 1985, and extending price controls to intrastate sales of gas.[13]

Because the structure of regulation between the NGA and the NGPA was substantially different, and because the literal language of section 154.93(b-1) referred to just and reasonable area ceiling rates prescribed by the Commission, doubt arose whether area rate clauses in existing interstate contracts provided sufficient contractual authority, and whether the NGPA or section 154.93(b-1) precluded their operation, to collect the applicable maximum lawful NGPA price.

On November 29, 1978, FERC issued its Interim Regulations implementing the NGPA. In 18 C.F.R. § 270.205 FERC provided:

§ 270.205 *Indefinite price escalator clauses.*

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[12]FERC had initiated a new national rate proceeding but stayed it in light of the pendency of the NGPA. Order No. 23, No. RM79-22, Slip Op. at 31 (March 13, 1979). Speculation thus abounds as to what price level FERC would have set for incentive categories had the NGPA not been enacted.

[13]The recurring, severe shortages on interstate pipelines during the Seventies spurred enactment of the NGPA. The NGPA's higher prices were intended both to increase the supply of gas reserves and production and to decrease consumption demand at the end-use level. *See* H.R.Rep.No.496, pt. IV, 95th Cong., 1st Sess. 101 (1977); Congressional Budget Office, The Natural Gas Compromise Report 2 (1978), *reprinted in* 124 Cong.Rec. H13126-27 (daily ed. Oct. 4, 1978).

(a) The establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate or interstate contracts.

(b) For purposes of this section, the term "indefinite price escalator clause" shall have the same meaning as provided in section 105(b)(3)(B) of the NGPA.

The preamble to the Interim Regulations explained that section 270.205 incorporated the discussion in H.R.Rep. No. 1752, 95th Cong., 2d Sess. 83 (1979),the Conference Committee Report on the final bill.This discussion related to the effect of the establishment of NGPA ceiling prices on indefinite price escalator clauses in existing intrastate contracts. FERC took the position that the interim regulations was consistent with the Conferees' discussion; FERC considered that discussion to be equally applicable to existing interstate contracts. FERC then heard oral arguments concerning the NGPA's effect on area rate clauses and other price escalator clauses. [368]

In a Policy Statement of January 24, 1979, FERC announced that, under a "plain meaning" construction, area rate clauses do not constitute contractual authority for the collection of NGPA ceiling prices. "Variant clauses" — escalation provisions that do not precisely reflect the exact language of section 154.93(b-1) — were considered inoperative under the regulation. These variant clauses additionally refer to rates established by any successor or other governmental authority. For intrastate contracts, the Commission explained that escalator clauses may increase the contract price in accordance with the contract terms, but not in excess of the applicable ceiling, and FERC would leave the interpretation of these clauses to the par-

ties and state courts. FERC did, however, provide that the parties to an existing interstate gas purchase contract were free to enter into amendments to provide the requisite contractual authority to collect NGPA rates. FERC also held that NGPA § 601(c)(2), which guarantees to interstate pipelines the pass-through of NGPA prices except in cases of fraud or abuse, would not preclude pass-through of increased purchased gas costs from a contract amendment in an arm's length transaction merely because the pipeline was unable to show an economic benefit from the amendment to its ratepayers. Finally, FERC indicated that the contractual amendment could be retroactive to December 1, 1978.

On February 13, 1979, FERC issued a Notice of Proposed Rulemaking to promulgate specific regulations effectuating the statement of policy. Extensive comments were again submitted. Those comments revealed that most interstate pipelines agreed that area rate clauses were sufficient contractual authority for producers to collect NGPA prices. FERC reversed its proposed position and issued Order No. 23.

In Order No. 23, FERC examined the legislative history of the NGPA and concluded that there was insufficient evidence to mandate the view that Congress intended to preclude the operation of area rate and variant clauses to collect NGPA prices. Lacking a clear prohibition, the doubt was resolved in favor of no statutory preclusion.

FERC also held that section 154.93(b-1) neither bars nor makes ineffective both area rate clause and variant clause escalation to NGPA prices. FERC looked not to the literal language of the regulation, but instead focused more broadly on its purpose and the past FPC practice of flexibly, rather than literally, applying section 154.93(b-1) in a

changing regulatory environment. Since the regulation was founded on the FPC's conclusion that the impermissible clauses were contrary to the public interest, the touchstone for application of section 154.93(b-1) is whether the escalation is in the public interest. Since NGPA rates are generally applicable ceiling rates, such escalation was not contrary to the public interest. Clauses made impermissible by section 154.93, however, would continue to be inoperative, or given only the effect of an area rate clause in accordance with any certificate waiver, if the gas under the contract is still within FERC's NGA jurisdiction.

FERC then turned to the question of contractual authority. Because area rate clauses vary considerably in their wording, and because at least one pipeline viewed its area rate clauses as escalating only to rates determined by agency proceedings, safeguarded by adversary participation and opportunity for judicial review of agency findings, FERC decided that a dispositive construction was impossible. Instead, FERC would provide a forum to give varying language and differing interpretations proper airing in the context of construing specific clauses. To provide guidance in these proceedings, FERC stated a general, administrative view with regard to contractual interpretation, while emphasizing that this was not to be taken as a dispositive view.[14]

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[14]FERC has continued to grapple with this question. The continuing evolution of interpretive aids is made evident by the Order on Rehearing of Order No. 23, Order No. 23-B, and Independent Oil & Gas Association of West Virginia (FERC Opinion No. 77), Nos. R174-188 & R175-21 (Mar. 4, 1980), *petition for review dismissed, Pennzoil v. FERC,* No. 80-1492, 645 F.2d 394 (5th Cir. May 20, 1981). In Opinion No. 77 FERC articulated in great detail the principles it intends to apply when resolving specific contractual interpretation disputes. Opinion No. 77 is not before us in this petition for

Since it is the intent of the parties that is controlling on [369] whether a particular clause authorizes collection of NGPA rates, FERC would endeavor to ascertain and give effect to the contracting parties' intention. FERC stated that the wording of a particular clause and the effect ascribed to it by the contracting parties would "generally be determinative." Although the contracting parties are not the only parties in interest to existing interstate gas purchase contracts, great weight is given to the parties' interpretation in questions of contract construction. The generally agreed interpretation asserted by substantially all sellers and buyers in the rulemaking comments was that the parties intended that the area rate clause permit escalation to the highest ceiling price permitted by governmental authority. FERC concluded that this was not an unreasonable interpretation of the contracting parties' intent, even for clauses that track the literal language of section 154.93(b-1). It therefore viewed variant clauses as even stronger cases for finding contractual authorization. Absent specific contractual language to the contrary, FERC would not interpose any general objection to the parties' reliance on area rate or variant clauses as authority to collect NGPA prices, and would give considerable weight to the mutual interpretation of the contracting parties.[15] The Commission also stated that it would not interpose any

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review and therefore this Court does not directly pass on it here. We note, however, that consistent with its position in Order No. 23, FERC is continually refining its guidelines to interpretation of escalation clauses.

[15]Order No. 23-B further elaborated on what that considerable weight would be. FERC redefined this weight as a rebuttable presumption of the accuracy of the interpretation. More specifically, FERC will presume that the parties know what they intended when they executed the contract, and that they are truthful in their assertion of that intent.

general objection to escalations by indefinite price escalators in existing intrastate contracts.

In the Order on Rehearing of Order No. 23, FERC clarified its view on contractual interpretation. It expressly rejected the "plain meaning rule" it had adopted in the Notice of Proposed Rulemaking, which requires, in the absence of ambiguity, a literal interpretation of the contract solely by reference to its language. Instead, FERC will interpret area rate clause language in light of its commercial context. This context includes the then prevailing scheme of NGA regulation and its limitation in section 154.93 at the time the clause was drafted. In Order No. 23-B, FERC noted that the course of the parties' conduct subsequent to the contract's execution can shed light not just on the contract's meaning, but may evince a modification of its original terms, such as by flexible adaptation of the use of area rate clauses as the regulatory environment changed.

The Commission established a protest procedure in Order No. 23-B for the determination of contractual authority in specific cases. The protest procedure is limited to gas over which FERC retains some continuing nonprice regulatory control under the NGA. This limits the protest procedure to existing interstate contracts that cover gas entitled to NGPA §§ 104, 106(a), 108, or 109(a)(2) maximum lawful prices.[16] FERC required that interstate pipelines

[16]Section 104, 15 U.S.C.A. § 3314, applies to gas committed or dedicated to interstate commerce on November 8, 1978, the day before the NGPA was enacted, and for which a just and reasonable rate under the NGA was in effect on that date. The maximum lawful price under this section is essentially a carry forward of the latest FPC national rate opinion. The only difference is that the NGPA substitutes its own more sophisticated inflation adjustment escalator.

Section 106(a), *id.* § 3316(a), applies to gas under any "rollover" contract that was committed or dedicated to interstate commerce on

submit the evidence the contracting parties claim authorizes the collection of higher rates since pipelines are in a better position than producers to supply the needed information to FERC and to interested persons.[17]

November 8, 1978. The maximum lawful price is again a carry forward of the earlier FPC national rates. The purpose of this section is to lock-in flowing gas to the earlier contract price even though the existing interstate contract expired and has been replaced by a "rollover" contract. A "new" contract is one executed on or after November 9, 1978, for gas not previously subject to an "existing" contract, while the latter is one in effect on November 8, 1978. NGPA §§ 2(11) & (13), *id.* §§ 3301(11) & (13). A "successor to an existing contract" is one other than a "rollover" contract, executed on or after November 9, 1978, for gas previously subject to an existing contract, while a rollover is one executed on or after November 9, 1978, for gas previously subject to an existing contract that expired at the end of a fixed term specified in the contract. NGPA §§ 2(12) & (14), *id.* §§ 3301(12) & (14). The distinction between successors and rollovers is directed at contracts cancelled by one or both parties rather than the life of a contract coming to its natural end.

Section 108, *id.* § 3318, applies to gas from a "stripper well," that is, gas not associated with crude oil production from a well that produces not more than an average of 60 Mcf per day. Other than deregulated gas, this category receives the most favorable pricing treatment.

Section 109(a)(2), *id.* § 3319(a)(2), applies to gas committed or dedicated to interstate commerce on November 8, 1978, and for which a just and reasonable rate under the NGA was not in effect on that date.

[17]The evidentiary submission must contain (1) the rate schedule number or date of each contract for which the seller has filed for a higher NGPA rate; (2) the seller's name for each contract; (3) the NGPA section or sections applicable to sales under each contract; (4) the text of the contractual provisions, as well as any other evidence such as the subsequent course of the parties' conduct, that the pipeline believes constitutes or may constitute the contractual authority to escalate the price to the NGPA ceiling; and (5) a list of those contracts that the pipeline contends do not authorize collection of a higher price.

These procedures are open not only to interstate pipe- [370]
lines, but to "third parties" such as the Commission Staff, state reglatory commissions, local distribution companies, and consumer groups. Although FERC will give considerable weight to the contracting parties' mutual interpretation, FERC will not allow that interpretation to control where it is unreasonable in light of the language of the contract and the conduct of the parties. As set forth in both Order No. 23-B and Order on Rehearing of Order No. 23-B, FERC adopted a bifurcated procedure for handling protests by third parties to the contracting parties' assertion of authority. If express contractual language is inconsistent with the parties' mutual interpretation, a hearing is ordered; if the language is not inconsistent, the protest is summarily dismissed unless the protestor submits other specific evidence that explains or modifies the text of the contract.[18] In other words, the protestor has the burden of coming forward with substantial evidence of the lack of contractual authority to overcome the presumption that the contracting parties' assertion regarding their intent is accurate and not unreasonable. If the protestor meets the burden of production, the contracting parties bear the burden of persuasion at the hearing to show by a preponderance of the evidence that contractual authority exists.

Pipeline protestors, however, do not face these same procedural presumptions to reach a hearing – if the contracting parties cannot agree as to their intent, there is no

[18]The protest must specifically identify the contract it addresses, include the text of the contract, and state the protestor's reasons why he or she believes it to be inconsistent with the conclusion that the contract authorizes the collection of higher rates. The protest may include other specific evidence, such as the commercial context or subsequent conduct of the parties, that demonstrates a lack of contractual authority.

presumption concerning that intent that must be overcome. In these cases, the burden of proof is entirely on the seller since he is the party seeking the rate increase.

Finally, in Order No. 23-A, FERC held that in any event the pipeline and producer are free to amend their contract to provide for collection of an applicable NGPA price. In connection with the NGPA's disallowance of amounts paid by the pipeline due to fraud, abuse, or similar grounds, FERC stated that it would resolve those issues on a case-by-case basis rather than by promulgating a general rule. It therefore rejected any requirement of additional consideration for the contract amendment, or other evidence of arm's length bargaining, before allowing a pipeline to pass through to its customers the higher prices paid under the amendment.[19]

[19]The Notice of Proposed Rulemaking indicated that contractual amendments for NGPA ceiling price collection could operate retroactively back to December 1, 1978. This position was taken out of fairness in that FERC's policy on area rate clauses was not issued until after the NGPA's effective date. In Order No. 23, the Commission noted but did not address the criticisms that it lacked authority to allow the retroactivity of such amendments. In FERC's view, its position in that order substantially decreased the need for amendments, which obviated the need to discuss retroactivity. In Order No. 23-A, the Commission was strangely silent on retroactivity. Nor was this matter resolved by the Order on Rehearing of Order No. 23-A. FERC merely adopted the suggestion that it make clear it has adopted no policy, rule, guideline, or presumption whether contract amendments may operate retroactively.

C. The Parties' Positions [371]

The positioning of the parties in this litigation appears complex, but can be simplified. There are three groups of petitioners: Pennzoil Company, *et al.;* Indicated Producers; and Consumer Petitioners and Intervenors (hereinafter Consumers).[20] The Pennzoil producer group filed petitions for review in the Fifth Circuit. Consumers filed petitions for review in the District of Columbia Circuit. The Indicated Producers filed in this and in other Circuits.[21] This Court determined that the winner of this venue "race to the courthouse" was the Pennzoil producer group, thus venue was ultimately vested in this Circuit and all cases were consolidated here.

The Pennzoil producer group and the Indicated Producers (which together will be referred to simply as Producers) ask this Court to reverse the orders on the ground that FERC should have conclusively declared area rate and other escalation clauses to be sufficient authority to collect NGPA prices. They demand that the protest procedures be invalidated because, if there is no question of authority, there is nothing to protest. Consumers, on the other hand, urge reversal on the ground that the statute, FERC regulations, and contract law preclude the use of area rate and variant clauses to collect NGPA prices. They further insist that the protest procedures violate due pro-

[20]The Independent Producer Respondents intervened solely in support of FERC's position.

[21]This spectacle of a race to the courthouse prompted this Court to amend its local rules on February 1, 1980. Local Rule 11 governs review of FERC orders. Local Rule 11.5 addresses venue, and provides that any dispute as to priority of institution of proceedings in two or more courts of appeal will be referred to FERC for findings of fact.

cess and should not have been limited to gas remaining within FERC's NGA jurisdiction.

II. *FERC COMPLIANCE WITH THE ADMINISTRATIVE PROCEDURE ACT*

[1] FERC's position in Order No. 23 was a sharp change from that in its Notice of Proposed Rulemaking. Fundamentally, this demonstrates not that the agency acted arbitrarily, but simply that the administrative process was working. The purpose of the Administrative Procedure Act (APA) notice and comment requirement is that the agency educate itself before adopting a final order. This assures fairness and mature consideration of rules having a substantial impact on those regulated. *See Brown Express Co. v. United States*, 607 F.2d 695, 701 (5th Cir. 1979). Simply because a different rule is adopted does not require a new notice and comment procedure if, as required by 5 U.S.C.A. § 553(b)(3), the notice of proposed rulemaking includes the terms or substance of the proposed rule or a description of the subjects and issues involved. This requirement is to sufficiently and fairly apprise interested parties of the issues involved, rather than to specify every precise proposal that the agency may ultimately adopt. *Action for Children's Television v. FCC*, 564 F.2d 458, 470 (D.C.Cir. 1977).

[2] In this case, all interested persons had ample opportunity to present their views on every facet of area rate [372]
clause operation under the NGPA. On January 12, 1979, FERC issued an order providing for written comments and oral argument before the full Commission on the legal and policy issues relating to the NGPA's effect on area rate and other price escalator clauses in interstate and intrastate contracts. The order listed nine questions that the

written and oral comments should address. These questions covered every substantive issue involved in the later proceedings – the effect of the NGPA, the effect of section 154.93, contractual interpretation by the parties, FERC's authority to interpret price escalator clauses, the possibility of contractual amendment, and the economic consequences of allowing escalation.

FERC again received input after it issued the February 13, 1979, Notice of Proposed Rulemaking that set forth its specific proposal to implement the January 24, 1979, statement of general policy. In making their comments, the parties not only had the Notice's further elaboration of the issues, they also had the dissenting views of Commissioners Smith and Sheldon.

Since FERC had a duty to consider the submitted comments, and since modification of proposed rules in light of written and oral presentations is the heart of the rulemaking process, FERC did not violate the APA.

III. *THE NGPA AND AREA RATE CLAUSE ESCALATION TO NGPA CEILING PRICES*

The text of the statute itself, its legislative history, and the structure and policy of the NGPA do not preclude area rate clauses from escalating the interstate contract price to the maximum lawful NGPA price. Nor does it, on the other hand, require such escalation.

A. *Ceiling Prices, Vintage Pricing, and Contractual Escalation*

The NGPA concept of "maximum lawful price" or "ceiling price" does not, contrary to the Consumers' contention, indicate an intent to preclude escalation to NGPA

prices by existing contracts. A ceiling price sets a maximum above which the sales price cannot go, but at the same time does not set a minimum; the sales price, given sufficient economic conditions, can be established at a point below that ceiling. A ceiling price must be distinguished from a "controlled" price. The latter is both a maximum and a minimum allowable price. With price ceilings, as opposed to controlled prices, the parties are free to contract for sale prices at or below, but not above, the ceiling. Similarly, the parties may adopt amendments increasing or decreasing the contract price so long as the amended price does not exceed the ceiling. Upward contractual escalation of the contract price does not convert the ceiling price into a price floor, but is instead consistent with the existence of a cap on price increases. Consumers' contention otherwise is inconsistent with past FPC price regulation, since area rate clauses escalated contract prices to newly established, higher FPC ceilings.

Nor does the NGPA's vintaging by price category — giving an incentive rate for gas that needs it such as "new" gas, but not for gas that needs no incentive such as already flowing gas[22] — preclude escalation. The vintaging is effected through the price category eligibility require-

[22]"[A] two-price rate structure will both provide a useful incentive to exploration and prevent excessive producer profits." *In Re Permian Basin Area Rate Cases*, 390 U.S. 747, 798, 88 S.Ct. 1344, 1376, 20 L.Ed.2d 312 (1968).

ments.[23] The NGPA would generate any additional consumption cost savings, through the preclusion of area rate clauses escalation, only if the NGPA incorporated existing contract prices as the maximum lawful price. This brings us to the main battleground over the interpretation of the statute: NGPA § 101(b)(9). This provides: [373]

> **§ 3311. Inflation adjustment; other general price ceiling rules**
>
> . . . .
>
> **(b) Rules of general application.**— . . . .
>
> **(9) Effect on contract price.**—In the case of—
>
> (A) Any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this subchapter, or
>
> (B) any price which is established under any contract for the first sale of natural gas which is exempted under part B of this subchapter from the application of a maximum lawful price under this subchapter,
>
> such maximum lawful price, or such exemption from such a maximum lawful price, shall not

[23]Eligibility turns on factual distinctions. Most are physical in nature: distance between wells; depth of completion locations; the date on which surface drilling began, on which production was dedicated to interstate commerce, or on which a reservoir was penetrated or discovered; average daily production; and special geological characteristics (geopressurized brine, coal seams, and Devonian shale). Many are legal: federal or state well-spacing requirement compliance; inclusion within a federal or state proration unit; the type of contract the gas is sold under (existing, successor, or rollover interstate or intrastate contract); state or Indian ownership of the production or royalties; and the intrastate contract price level. A few distinctions are economic: production in paying or commercial quantities, and production that involves extraordinary risks or costs.

supersede or nullify the effectiveness of the price established under such contract.

To properly decide whether section 101(b)(9) codified the existing contract price as the maximum lawful price, however, a brief review of the *"Mobile-Sierra"*[24] doctrine is necessary. .

1. *The Mobile-Sierra Doctrine*

In the *Mobile* case, the issue was whether NGA § 4 gave a seller any power to avoid a fixed price contract simply by filing with the Commission a proposed rate increase without the concurrence, and even over the objection, of the buyer. Under NGA § 4(d), no change in rates can be made except after thirty days notice to the Commission. Whenever any such rate increase filing is made, the Commission has the authority under section 4(e) to hold a hearing on the lawfulness — the justness and reasonableness — of the rate increase.[25]

The basic thrust of *Mobile* is that the NGA did not displace but only superimposed federal regulation on private contractual arrangements. The Supreme Court contrasted the NGA, which by virtue of its ceiling price structure allows parties to set the rates initially by con-

[24] *United Gas Pipe Line Co. v. Memphis Light, Gas & Water Division*, 358 U.S. 103, 79 S.Ct. 194, 3 L.Ed.2d 153 (1958) (Harlan, J.); *Federal Power Commission v. Sierra Pacific Power Co.*, 350 U.S. 348, 76 S.Ct. 368, 100 L.Ed. 388 (1956) (Harlan, J.); *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 76 S.Ct. 373, 100 L.Ed. 373 (1956) (Harlan, J.)

[25] During the 30 day period the Commission may suspend the proposed rate increase for up to five months to determine whether the new rate is just and reasonable. If after five months no determination is made, the proposed rate increase becomes effective automatically, subject to refund if the Commission later finds the new rate is not just and reasonable.

tract, with the Interstate Commerce Act, which by its uniform rate requirement (that is, controlled prices) precludes initial contractual ratesetting. In light of this difference, the *Mobile* Court concluded that the NGA did not abrogate private rate contracts, but simply provided protection for the public interest through the statutory filing procedures and notice requirements and the Commission's power to review rate increases and modify them if found unlawful. The Court noted that the NGA presumes seller capacity to make and change rate contracts, but these private contractual powers remain undefined and unaffected by the NGA. These powers are therefore no different than those which sellers would possess absent the NGA. Otherwise valid changes are ineffective without the required notice to the Commission; the NGA's existence provides no basis to validate unilateral contract changes, no additional powers to make or change rates, only notice to and review by the Commission.

[3] In essence, then, since a seller needs contractual [374] authority to collect NGA rates, a seller needs contractual authority to legally file for a rate increase under NGA § 4(d). Simply put, rate filings consistent with contractual agreements are valid; those inconsistent with contractual obligations are not. *Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir.), *cert. denied*, 414 U.S. 1068, 94 S.Ct. 578, 38 L.Ed.2d 473 (1973). If the seller lacks authority to make the filing, the Commission lacks jurisdiction to entertain the filing and to determine the lawfulness of the rate increase.[26] Contractual authority thus was a threshold issue that the Commission had to face.

[26]The Commission in a sense has "ancillary" jurisdiction under § 4 to determine whether sufficient contractual authority exists for it to entertain the rate increase filing. It is similar to federal court "jurisdiction to determine jurisdiction." *See, e.g., United States v. United Mine Workers of America*, 330 U.S. 258, 67 S.Ct. 677, 91 L.Ed. 884

In *Mobile* the seller had a fixed price contract and therefore lacked authority to make a unilateral rate increase filing.[27] In *Memphis,* the seller had a "going rate" contract that left the price term open; the Court held that this gave the seller authority to file unilaterally for rate increases. The *Memphis* Court also noted that contracts with provisions to change the rate during the contract term — escalation clauses — would be valid contractual authority to make a unilateral rate increase filing, subject only to the limits and procedures of the NGA.

2. *NGPA § 101(b)(9).*

[4] With this conceptual framework in mind, it becomes apparent that section 101(b)(9) does not codify existing contract prices as the ceiling price. Section 101(b)(9) provides that the applicable maximum lawful price, or any applicable price deregulation, "shall not supercede or nullify the effectiveness of the price established under" any contract that does not exceed the applicable maximum lawful price. This simply codifies the ceiling price corollary made plain in *Mobile-Sierra:* the statute's operation is limited to keeping sales prices from exceeding

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(1947). The Commission's § 4 ancillary jurisdiction to determine contractual authority is concurrent with state courts, not exclusive or primary. *Rowan v. Allied Chem. Corp.,* 39 F.P.C. 64 (1968).

[27]In *Sierra,* provisions of the Federal Power Act virtually identical to the NGA were involved. The seller had a fixed price contract, therefore, on the authority of *Mobile* the Court held that the seller lacked authority to make a unilateral rate increase filing. The Court further noted that the seller can by contract agree to a rate affording less than a fair return on net capital, and the Commission may not relieve it of its improvident bargain unless the rate is so low that the public interest is adversely affected. The purpose of the Commission's statutory power to change rates is the protection of the public interests, not the private interests of sellers.

the ceiling, therefore contractual authority is required to collect permissible rates, and sellers are given no power to avoid the obligation of a fixed price contract. The statute and its legislative history confirm this view.

First, Congress knew how to codify existing contract prices as maximum lawful prices when it meant to do so. Sections 105 and 106(b) apply to gas under an intrastate contract that was in effect on the NGPA's date of enactment. These are the only NGPA provisions that expressly make the contract price the maximum lawful price. If the contract price on November 9, 1978, was greater than the section 102 new gas price, then under section 105(b)(2) the maximum lawful price is that November 9th contract price until the section 102 price catches up to the inflation adjusted contract price.[28] If, on the other hand, the price on November 9th was less than section 102, under section 105(b)(1) the maximum lawful price is the current price provided for under the terms of the contract as long as it does not exceed the section 102 price. Therefore, in the latter case, the intrastate contract price may escalate from its November 9th level to the section 102 level, provided that [375] the contract has a sufficient escalation mechanism. H.R. Rep. No. 1752, 95th Cong., 2d Sess. 82 (1978); 124 Cong. Rec. H13117 (daily ed. Oct. 14, 1978) (statement of Rep. Dingell). Section 106(b) essentially carries forward for intrastate "rollover" contracts the section 105 pricing under

[28]Under § 105(b)(2)(B)(ii), the November 9th contract price is adjusted monthly by an inflation factor provided for in § 101(a). The § 102 price is adjusted by the same monthly inflation adjustment factor, plus an additional "real growth" factor provided for in § 102(b)(2)(B). Although the contract price may be higher than the § 102 price initially, the faster rate of increase for the § 102 price means that at some point the two prices will "crossover." The maximum lawful price is then no longer the adjusted contract price, but instead switches to the higher § 102 price. 124 Cong.Rec. H13117 (daily ed. Oct. 14, 1978) (statement of Rep. Dingell).

the existing intrastate contract that expired at the end of a fixed term specified in the contract.[29]

Congress thus codified intrastate prices existing on November 9th if higher than section 102, but codified the "contract schedule of prices or contract mechanism for establishing prices *over time*" subject to the cap of section 102 if the November 9th price was less than section 102. 124 Cong. Rec. H13117 (daily ed. Oct. 14, 1978) (statement of Rep. Dingell) (emphasis in original). This elaborate incorporation of either the contract price or the contract escalation provisions into the maximum lawful price would have been totally unnecessary if section 101(b)(9) froze existing, November 9th contract prices.

Secondly, the critical language in section 101(b)(9) is not just the phrase, "supersede or nullify," but also the phrase, "price . . . established under [a] contract." The latter connotes contract terms that create or modify the price term. In other words, the rule in section 101(b)(9) includes a price established by an escalation clause.[30] It would be an entirely different case if section 101(b)(9) expressly referred to prices established or in existence on, for example,

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[29]Section 106(b) provides that the maximum lawful price is the higher of the maximum lawful price last paid under the expired contract, adjusted thereafter by the monthly inflation factor, or in the case of a rollover in April 1977, a per unit price of $1.00, also adjusted thereafter by the monthly inflation factor. This permits very low price intrastate contracts that rolled over when the National Energy Plan was announced to receive some increase before becoming locked in until deregulation in 1985.

[30]Sections 105(b)(3)(A) and 121(e), which limit the operation of certain indefinite price escalator clauses, also refer to a "price established under [an] indefinite price escalator clause."

the day of enactment of the NGPA (as section 105(b)(2) does).

Finally, the legislative history shows that section 101(b)(9) does not codify existing contract prices. Representative Dingell introduced a comprehensive explanatory statement into the Congressional Record to encourage enactment. 124 Cong.Rec. H13115-20 (daily ed. Oct. 14, 1978). With regard to section 101(b)(9), he stated that FERC had no direct enforcement authority of contract prices per se, only of maximum lawful prices, since section 101(b)(9) was simply a rule of construction and did not establish any requirements for ceiling prices. Because the statute imposes ceiling price regulation, Representative Dingell explained, the maximum lawful price supersedes the contractual arrangement only when the contract price exceeds the maximum lawful price; when the contract price is less than the maximum lawful price, the contractual arrangement continues to govern the parties' relationship. Note that it is the contractual *arrangement* and not the price alone that continues to govern. Representative Dingell was thus emphasizing that it is in the very nature of the ceiling price concept that the contract controls in the first instance, and that section 101(b)(9) is not a pricing provision.

In light of the *Mobile-Sierra* doctrine, and the ceiling price structure of NGPA and NGA producer rate regulation, this Court holds that section 101(b)(9) is Congress' express and specific intent not to preempt the ability of private persons to contractually govern their relationship. Although Consumers would convert the NGPA's structure into one based on controlled prices, section 101(b)(9) is simply a necessary component of the ceiling price concept: the statute overrides contractual provisions only to the extent that the contractual terms provide for prices in *excess* [376]

of the statutory ceilings. Therefore, section 101(b)(9) is not a limit on the operation of area rate clauses.

B. *The NGPA Conference Committee Report and Statutory Limitaions on Contractual Escalation*

Varying interpretations of the Conference Committee Report's discussion of section 105(b)(3)(A) has unfortunately generated considerable debate and confusion with regard to legislative intent on the operation of area rate clauses. The Conferees stated that they did not intend mere establishment of NGPA ceiling prices to trigger *intrastate* contract indefinite price escalator clauses. It was this statement that formed the basis for section 270.205 of the Interim Regulations; the Commission extended the Conferee's discussion to apply also to interstate contracts, that is, establishment of NGPA ceiling prices would not trigger area rate clauses. Much of the argument between the parties centers on this Conference Committee language and its meaning. To properly interpret this language, however, the first step is to examine the statute to which this part of the legislative history relates.

[5, 6] The NGPA limits the operation of escalation clauses in four instances. None of these has any applicability to the operation of area rate clauses. The first instance limits the operation of both indefinite price escalators[31] and definite price escalators, simply by the existence of the

[31]The NGPA defines an indefinite price escalator clause as one that adjusts the contract price by reference to *other prices* for natural gas, crude oil, or refined petroleum products, or adjusts the price by negotiation between the parties. NGPA § 105(b)(3)(B), 15 U.S.C.A. § 3315(b)(3)(B).

Producers argue that area rate clauses do not come within this definition. They read the definition to mean a provision that refers to prices paid in other sales. Their interpretation would limit the definition to favored nation clauses, which expressly refer to prices paid in

ceiling price of the category for which the gas under the contract can qualify. For example, section 105(b)(2) makes the November 9, 1978, contract price the maximum lawful price until that inflation adjusted price is surpassed by the section 102 price as adjusted for inflation and real growth. *See* note 28 *supra*. Escalator clauses in contracts subject to section 105(b)(2) are thus limited in their operation to the statutory inflation adjustment rate until the section 102 price becomes the maximum lawful price, at which time they can escalate at the inflation and real growth rates. 124 Cong.Rec. H13117 (daily ed. Oct. 14, 1978) (statement of Rep. Dingell). This same limited monthly escalation applies to all contracts whose prices have reached the ceiling cap of their respective applicable pricing category. Under section 105(b)(1), on the other hand, the maximum lawful price is the lower of the section 102 price or the current price under the existing intrastate contract (rather than the November 9th price). If the contract has an escalation provision, definite or indefinite, it may increase the contract price up to but not in excess of the section 102 price, and then can escalate only at the statutory inflation and real growth adjustment rates. *See* H.R.Rep. No. 1752, 95th Cong., 2d Sess. 82 (1978); 124

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other sales. The statutory definition is not so narrow, however. The statute says "other prices for natural gas" and not "prices paid in other sales of natural gas" or even "other prices paid for natural gas." The statutory definition is broad enough to encompass provisions that refer to other prices permitted for natural gas, that is, ceiling prices. Therefore, § 105(b)(3)(B) encompasses provisions that refer to other prices paid or permitted. After all, aside from the statutory definition, an area rate clause is an indefinite price escalator clause since it adjusts the initial price by reference to contingent events, rather than by a specific amount at definite future dates. *See* H. Williams & C. Meyers, Manual of Oil & Gas Terms 138 (4th ed. 1976). That area rate clauses fall within the definition of an indefinite price escalator clause does not, however, limit area rate clause operation. Area rate clauses must also fall within the terms of a statutory limitation, not just within a definition, for their operation to be statutorily circumscribed.

Cong.Rec. H13117 (daily ed. Oct. 14, 1978) (statement of Rep. Dingell).[32] The only category with a higher regulated price than section 102 is section 108 (stripper well [377] gas). Once the contract price is escalated to the section 102 price, the contract can receive the section 108 price only if the gas under that contract independently qualifies for section 108 pricing. If it does, then the escalation provision could elevate the contract price to the section 108 price, and continue to escalate the contract price in accordance with the inflation and real growth adjustments provided for in section 108(a)(2).

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[32]Definite escalator clauses simply increase the contract price steadily. If the contractual rate of increase is faster than the § 102 inflation and real growth adjustment rates, the contract price under § 105(b)(1) would recei /e the § 102 price at some point. Its escalation would then be limited to the § 102 rate of adjustment. If the intrastate contract contained a favored nation clause, the clause could elevate the contract price to the higher prices for other sales within the contract pricing area, but no higher than the current § 102 price. For example, a § 103 sale in the contract pricing area that was higher than the current contract price would trigger escalation of that contract to the § 103 price. This occurs even though the gas does not qualify for § 103 since the favored nation clause is free to operate and the § 103 price is currently less than the § 102 price. Similarly, the favored nation clause could escalate the contract price to the § 102 price paid in a sale in the contract pricing region. If the gas does not qualify for § 108 and there was a § 108 sale in the contract pricing areas, however, the favored nation clause could escalate the contract price only to the § 102 price since the § 108 price is higher than § 102.

Some foresighted intrastate producers included legislative rate clauses in their contracts against the day Congress extended federal price controls to the intrastate market. This clause will not escalate the § 105(b)(1) contract's price to the § 102 price. The maximum lawful § 105(b)(2) rice is the lower of the current contract price or the § 102 price. Absent some other escalation mechanism or ability to qualify under some other pricing category, the current unescalated price is the maximum lawful price. In other words, the escalation provision is, in effect, looking to itself, and cannot be used to bootstrap the price any higher. The legislative rate clause, however, would suffice for collection of the maximum lawful price of some other category if the gas under the contract qualified for that category.

The second limitation is section 105(b)(3)(A). This continues regulation for gas priced under section 105 and whose existing or successor contract price is determined by an indefinite price escalator provision. On the other hand, gas priced under section 106(b), regardless of whether the rollover contract's price is determined by an indefinite price escalator, and gas priced under section 105, but whose price is determined without any escalator or only by a definite escalator provision, is generally entitled to price deregulation in 1985.[33] Not only is gas priced under section 105(b)(3)(A) not entitled to deregulation, the continuation of maximum lawful prices for it prevents the indefinite price escalators from increasing the contract price from its current section 105 level to the deregulated price of some other producer. Too rapid an escalation in prices is prevented; deregulation occurs more gradually as individual existing and successor contracts expire by their own terms.

Section 313 provides two other limitations on the operation of indefinite price escalator clauses, for reasons

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[33]Section 121(a)(3), 15 U.S.C.A § 3331(a)(3), provides that gas sold under an existing, successor, or rollover intrastate contract at a price on December 31, 1984, of more than $1.00 per MMBtu is no longer subject to any maximum lawful price. Section 121(e) then provides that gas under an existing or successor intrastate contract, otherwise deregulated by § 121(a)(3), is subject to § 105(b)(3) if the contract price is established by an indefinite price escalator clause. Section 121(e) is thus a cross-reference to § 105(b)(3).

Section 105(b)(3)(A) limits the operation of indefinite price escalators by providing that if the existing or successor intrastate contract price is greater than $1.00 on December 31, 1984, and that contract price is determined by an indefinite price escalator clause, then once deregulation occurs under § 121(a)(3), the maximum lawful price will be the higher of the November 9, 1978, contract price, as escalated by the inflation adjustment factor, or the January 1985 § 102 price, as escalated by inflation and real growth adjustment factors, though the real growth factor here is smaller than the one for § 102 itself.

similar to those underlying section 105(b)(3)(A). The first, section 313(a), is that any such clause (in both intrastate and interstate contracts) cannot escalate the contract price to the section 107 "high cost" natural gas price unless the gas under the contract qualifies for section 107 pricing. This prevents a producer from receiving the section 107 price merely because some other producer receives it.[34] [378] The second, section 313(b), is that any indefinite price escalator clause may not escalate the contract price to section 302 emergency sale or section 302 emergency allocation prices. Again, section 313 limits the use of an indefinite price escalator clause to reach prices for which the gas in question is not otherwise qualified.

Earlier bills limited the operation of contractual provisions that determine the contract price on the basis of "sales of other natural gas," and later refinements continued to preserve the scope of the limitation so as not to include area rate clauses. *Compare, e.g.*, S.1469, 95th Cong., 1st Sess. § 412(c) (1977) *with* 15 U.S.C.A. § 3315(b)(3)(A) & § 3373. This reflects the congressional awareness that area rate clauses do not pose the danger of increasing the contract price above the applicable ceiling, of bootstrapping the contract price to ineligible maximum lawful prices, or of prematurely increasing the contract price to a deregulated rate, since the area rate clause is keyed only to an *applicable regulated* price. The necessity to limit the operation of area rate clauses was thus absent.

The Conference Committee Report states that section 105(b)(3)(A) applies only to intrastate and not interstate

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[34]Some § 107 gas is now deregulated. FERC Order No. 78, No. RM79-44 (Apr. 25, 1980) (deregulating gas qualifying under § 107(c)(1) through (4)). The remainder receives the § 102 price.

contracts; the Report explained that FPC regulations barred the use of indefinite price escalator clauses in interstate sales. Clearly, the Conferees were referring to impermissible clauses prohibited by section 154.93, since area rate clauses were expressly permitted under FPC regulation of interstate contracts. *See also Texaco, Inc. v. FPC*, 317 F.2d 796, 800 (10th Cir. 1963), *rev'd*, 377 U.S. 33, 84 S.Ct. 1105, 12 L.Ed.2d 112 (1964) (expressly referring to permissible provisions as definite price-changing clauses and to impermissible ones as indefinite price-changing clauses). This point is evident from the Conferees' entire discussion. For example, the Conferees further explained that they did not intend mere establishment of NGPA ceiling prices to trigger intrastate contract indefinite price escalator clauses, but that once gas was sold pursuant to an NGPA ceiling price, indefinite price escalator clauses could be activated, as limited by section 105(b)(3)(A). In other words, favored nation clauses are triggered by prices paid in other sales, not by mere enactment of a ceiling price that is higher than the contract price at the time. Area rate clauses, in contrast, were triggered by establishment of higher permitted prices.[33] The Consumers' contention that the Conferees meant to limit the operation of area rate clauses is thus not supported by the statement in the Conference Committee Report. Therefore, Congress was not only aware of the use of area rate clauses in interstate con-

[33]Senator Jackson also remarked that § 105(b)(3)(A) applies only to existing intrastate contract indefinite price escalator clauses, that some interstate contracts have indefinite price escalator clauses, but that FPC regulations prohibit their operation, and that the Conferees had no intent to change those prohibitions. 124 Cong.Rec. S15021 (daily ed. Sept. 13, 1978). Again, area rate clauses were permissible, not prohibited by FPC regulations, and interstate contract indefinite price escalators generally are either area rate clauses or are impermissible clauses that are subject to a certificate waiver of § 154.93 that allows these clauses to operate only as an area rate clause and no more.

tracts and of other types of indefinite price escalators in intrastate contracts, it expressly limited the operation of price escalator clauses in four instances, thereby allowing escalator clauses to otherwise operate according to their terms. None of these limits apply to area rate clauses.

C. *FERC Responsibility to Consumers*

[7] FERC's interpretation of the NGPA as not precluding area rate clause escalation is not an abdication of its responsibility to protect consumers. The NGPA is a fundamental change in regulatory outlook. Contrary to the Supreme Court's assumption in *Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672, 74 S.Ct. 672, 98 L.Ed. 1035 (1954), which subjected gas producers to utility-type [379] regulation under the NGA, Congress apparently decided that gas producers do not have "natural" monopoly power; that is, the industry does not possess the inherent technical characteristics that prevent its efficient and economical operation unless operated as a monopoly.[36] Therefore, the theory that a regulatory agency is necessary to represent consumers when they bargain on rates with a natural monopolist like a utility no longer applies to gas production. *See generally* Goldberg, *Regulation and Administered Contracts,* 7 Bell J. Econ. 426 (1976). FERC has a fundamentally different regulatory obligation, a nar-

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[36]*See* J. Bonbright, Principles of Public Utility Rates 10-13 (1961). The congressional assumption concerning lack of producer natural monopoly power is evidenced in the phased deregulation of wellhead prices and the elimination of FERC regulatory control under the NGA over gas eligible for § 601(a)(1). The continuation of price controls on older, cheap gas relfects only a concern about preventing financial windfalls to sellers with very low-cost gas properties, and not a concern about natural monopoly power.

rower authority to administer the NGPA and to prescribe *higher* price ceilings only in certain circumstances. *See* NGPA §§ 104(b)(2), 106(c), 107(b) & 109(b)(2), 15 U.S.C.A. §§ 3314(b)(2), 3316(c), 3317(b), & 3319(b)(2). The balance Congress struck already took into account the conflicting interests of producers and consumers.[37]

D. *The Justness and Reasonableness of NGPA Prices and Contractual Escalation*

[8] Thus, the NGPA does not preclude ecalation of area rate clauses to NGPA prices. On the other hand, contrary to the Producers' assertion, the NGPA does not require that area rate clauses escalate prices to NGPA levels. Producers rely on section 601(b)(1), which deems any amount paid under the NGPA to be just and reasonable for purposes of NGA §§ 4 & 5.

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[37]Congress carefully considered thc economic impact of the NGPA in designing that Act. *See, e.g.*, H.R.Rep. No. 496, pt. IV, 95th Cong., 1st Sess. 96-101, 110-21 (1977); Natural Resources and Commerce Division, Congressional Budget Office, The Natural Gas Compromise (Aug. 2, 1978), *reprinted in* 124 Cong.Rec. H12126-27 (daily ed. Oct. 14, 1978); Energy Information Administration, U.S. Dep't of Energy, Analysis Memorandum No. AM/IA-7902, An Evaluation of Natural Gas Pricing Proposals (June 14, 1978). Consumers contend that FERC must also undertake an economic impact study to determine whether Order No. 23 is consistent with the legislative purpose. However, an economic study is required only when FERC must review rates to see if they are just and reasonable, or review a pipeline curtailment plan to see if it results in a just and reasonable allocation of gas. *See, e.g., North Carolina v. FERC*, 584 F.2d 1003 (D.C.Cir.1978) (end-use allocation). Therefore, FERC was not required to determine the economic impact of Order No. 23 since the justness and reasonableness of NGPA ceiling prices is not at issue. "Just and reasonable" is merely a term of art for the public interest, and no one contends that congressionally established prices are not prescribed in the public interest.

Assuming without deciding that the NGPA deemed its prices just and reasonable for all purposes,[38] that does not by itself mean that escalator clauses *must* escalate to that price. Under the *Mobile-Sierra* doctrine and section 101(b)(9), the existence of ceiling prices – regardless of whether those prices are just and reasonable – does not of its own force escalate the contract price. That the statute does not preclude the escalation of area rate clauses merely [380] leaves open whether section 154.93(b-1) and the contractual provisions themselves authorize that escalation.

IV. *FERC JURISDICTION TO REGULATE AND INTERPRET GAS PURCHASE CONTRACTS*

[9] Before reaching FERC's interpretation of section 154.93(b-1) and its position concerning contract interpretation, the threshold issue of FERC jurisdiction to interpret existing contracts and to apply its regulation to contracts must be resolved. For purposes of this opinion,

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[38]FERC argues that the § 601(b)(1)(A) language "amount paid" refers only to pipeline payments of NGPA prices and not producer receipt of those payments. The statute, however, does not mandate such a narrow interpretation. The purpose of § 601(b)(1) is to set the necessary predicate for § 601(c). Section 601(c)(2) guarantees to interstate pipelines the ability to pass through NGPA payments. Clearly, that relates only to pipelines. Section 601(c)(1), however, provides that FERC may not deny or condition the grant of any certificate under NGA § 7 based upon the amount paid in a sale of gas if the amount is deemed just and reasonable under § 601(b). While the NGPA has reduced the universe of possible producer applications for NGA § 7 certificates for sales beginning after the enactment of the NGPA, it has not eliminated that universe. Since § 601(c)(1) can apply to producer as well as pipeline certificates, § 601(b)(1)(A) cannot be limited to pipeline payments simply on the basis of the language "amount paid." Whether there is some other support for FERC's view is left to a future decision.

existing gas purchase contracts can be divided into four categories. First, there are those contracts covering gas that remains within FERC jurisdiction under the NGA. Section 601(a)(1)(B) removes from continuing NGA jurisdiction sales of certain gas that nevertheless was committed or dedicated to interstate commerce on November 8, 1978, with this removal effective December 1, 1978. In short, this section reduces the amount of gas subject to the NGA. NGPA § 601(a)(1)(A) further provides that gas which on November 8, 1978, was not committed or dedicated to interstate commerce is exempt from NGA jurisdiction effective December 1, 1978, even if it is thereafter sold into interstate commerce. In other words, section 601(a)(1)(A) prevents the universe of gas subject to the NGA from expanding. Gas committed or dedicated to interstate commerce on November 8, 1978, and not removed from NGA jurisdiction by section 601(a)(1)(B), is priced under sections 104, 106(a), 108, or 109(a)(2).[39]

The second category of contracts, then, covers gas that once was but is no longer within FERC's NGA jurisdiction

[39]Sections 104 and 106(a) merely carry forward the most recent FPC national rate opinion. As FERC stated in Order No. 23, the section 104 prices are "based and inextricably linked to" previously prescribed FPC rates. Section 104 freezes the FPC rates as of April 20, 1977, and modifies in NGPA § 101 the inflation adjustment mechanism from that established by the FPC. Section 106(a) is essentially of the same nature as § 104, except that Congress utilized a specific formula that approximates prior FPC rates. Section 109(a)(2), on the other hand, is a catch-all provision when the gas cannot qualify under any other category. It applies to gas that was committed or dedicated to interstate commerce on November 8, 1978, but for which there was no just and reasonable NGA rate in effect on that date. Section 108 is a special incentive rate for stripper wells, that is, marginal production. Unlike the other incentive rate categories, gas dedicated to interstate commerce is not removed from NGA jurisdiction upon qualification for § 108 pricing. The § 108 rate, however, is the highest regulated rate provided for by the NGPA.

by virtue of NGPA § 601(a)(1)(B). This gas is under an existing interstate contract, but receives an incentive price under section 102 (new gas), 103 (new onshore production well), or 107 (high-cost gas). The third category is a hybrid of the first two — gas under an existing interstate gas purchase contract that is the subject of a pending eligibility determination that the gas qualifies for section 102, 103, or 107. Completion of the eligibility determination process would then result in section 601(a)(1)(B) removal of that gas from NGA jurisdiction.[40] The fourth and final category comprises existing intrastate rather than interstate, gas purchase contracts that cover gas priced under sections 105, 106(b), or one or the incentive price categories.

Under the *Mobile-Serra* doctrine, contractual authority is necessary for a seller to make a valid rate increase filing under NGA § 4; therefore the Commission has "ancillary" jurisdiction to interpret the contract to find whether that contractual authority exists. Because NGA § 4 remains applicable to the first category, any seller who must file under NGA § 4 for a rate increase must do so to collect any rate increase authorized by NGPA §§ 104, 106(a), 108, or 109(a)(2). FERC thus retains NGA jurisdiction to interpret area rate clauses in the first category of contracts.[41]

[40]Under NGPA § 503, 15 U.S.C.A. § 3413, state and federal agencies with regulatory jurisdiction over gas production determine whether gas qualifies for §§ 102, 103, 107,and 108. These determinations are subject to FERC review.

[41]In other words, when the NGA continues to govern, the *Mobile-Sierra* doctrine continues to apply, which requires that FERC determine, when presented with a rate increase filing, whether the contractual arrangement between the parties authorizes the collection of NGPA rates. Since the NGPA maximum lawful price is congressionally prescribed in the public interest, there is no issue concerning the lawfulness of the rate increase. FERC thus need only decide the question of the seller's contractual authority to collect the NGPA prices.

FERC also retains jurisdiction to apply section 154.93 to these existing interstate contracts. [381]

Since the second category comprises existing interstate contracts covering gas removed from NGA jurisdiction by section 601(a)(1)(B), FERC can no longer interpret or apply section 154.93 to these contracts. Whether such a contract authorizes escalation to NGPA prices is for state or federal courts to decide, unless the NGPA vested in FERC independent authority to interpret contracts concerning gas not within FERC's NGA jurisdiction.

Consumers contend that FERC has this independent authority under the NGPA. As support, they cite the section 501 general rulemaking authority to administer the NGPA, and its necessary or appropriate implementation and enforcement power. They also cite section 504, which declares it unlawful to sell gas at a rate greater than the applicable maximum lawful price or to otherwise violate any provision of the NGPA, and provides that, when enforcing the NGPA, FERC may seek federal court injunctive relief, impose civil penalties for knowing violations, and impose criminal penalties in certain cases.

If violating the contract constituted a violation of section 101(b)(9), as Consumers claim, and therefore a violation of "any" NGPA provision under section 504(a)(2), FERC could prohibit sales at a price above the contract price, rather than only sales at a price above the maximum lawful price. As discused above, however, section 101(b)(9) simply expresses an intent that the mere establishment of federal ceiling prices does not preempt the contractual power of private parties. Selling above the contract price violates not the NGPA but only private contractual limitations as long as the selling price does not exceed the ap-

plicable ceiling.[42] With the exception of sections 105 and 106(b) (the only provisions to actually incorporate the contract price as the maximum lawful price), FERC simply has no general contract price enforcement authority under the NGPA independent of that given it by NGA § 4 and NGPA §§ 105 and 106(b).

The third category concerns gas awaiting a jurisdictional agency determination that it qualifies for section 102, 103, or 107, which would trigger section 601(a)(1)(B) removal from NGA jurisdiction. FERC's NGA jurisdiction to apply section 154.93 and to interpret contracts seemingly continues until the eligibility determination is completed and becomes final. Shell Oil Company, however, contends that since section 601(a)(1)(B) makes removal of qualifying gas from NGA jurisdiction effective on December 1, 1978, a subsequent determination that the gas so qualifies should make that removal retroactive. From this they argue that FERC lacks jurisdiction over this gas, or in the alternative it is unreasonable for FERC to exercise such jurisdiction.

FERC has in fact provided in section 273.204 that a determination of eligibility for section 102, 103, or 107, will permit retroactive collection of those rates. The retroactivity of rate collection, however, does not answer whether FERC possesses NGA jurisdiction to regulate and

[42]Consumers also cite § 315(c), which provides that FERC may require the filing of new contracts with interstate pipelines. That section, however, requires that only the interstate pipeline, not the producer, file the new contract. No authority to interpret existing interstate contracts is implied by such a provision. Section 315(c) gives FERC the ability to regulate specified nonprice terms and conditions of service – to police the duration of new contracts as required under § 315(a) and to enforce § 315(b) rights of first refusal upon expiration of contracts deregulated from NGA jurisdiction by § 601(a)(1)(B). *See* H.R.Rep. No.1752, 95th Cong., 2d Sess. 110-11 (1978).

interpret contracts until such time as the eligibility determination becomes final. The very nature of retroactivity is that the effectiveness must be *deemed* to have existed at a time which in fact it did not. Therefore, it is only when the determination process is complete that FERC loses its NGA jurisdiction over contract regulation and interpretation.

Whether FERC discretion to exercise its jurisdiction is reasonable in these circumstances is another question. When the gas is determined to qualify for removal from NGA jurisdiction, FERC then loses its jurisdiction and would have to dismiss any pending contractual interpretation determinations. This compels participation in proceedings that may later be rendered moot, and thus the parties will be inconvenienced and incur expenses needlessly. Protest proceedings completed prior to the final eligiblity determination, though made when FERC had jurisdiction, would become void because of the retroactive lack of jurisdiction. This would necessitate burdensome court relitigation of the contractual authority issue since the void FERC decision would have no res judicata effect. The waste of legal resources that relitigating specific area rate clauses entails renders FERC's automatic exercise of this jurisdiction unreasonable. It is therefore incumbent upon FERC to reasonably exercise its discretion and allow producers who have made eligibility determination filings for sections 102, 103, and 107 to file for a stay of any protest proceeding until the pricing category determination is completed.[43] This Court thus partially sets aside Order on

[43]Such a stay may be sought under NGPA § 502(c), 15 U.S.C.A. § 3412. This permits any person to seek adjustments, including an exception or exemption from FERC rules or orders, as may be necessary to prevent special hardship, inequity, or an unfair distribution of burdens. A stay can also be sought under 18 C.F.R. § 1.7(b), which

Rehearing of Order No. 23-B to the extent of FERC's position that it must interpret contracts in this third category and that any completed interpretations will govern until the eligibility determination becomes final.

The fourth category – existing intrastate contracts – is clearly beyond FERC's NGA contract interpretation jurisdiction. Since FERC has no independent section 101(b)(9) authority to interpret contracts, FERC's jurisdiction to do so is limited to a determination of what is the section 105 or 1066 ceiling price. Contractual authority questions concerning intrastate contract escalation provisions are otherwise left to state or federal courts.

V. *FERC INTERPRETATION OF SECTION 154.93(b-1)*

Section 154.93, an exercise of the Commission's NGA power to determine whether rates are just and reasonable and to set aside any that are not, limited the type of contractual authority a producer could use. The Commission determined in advance that the impermissible clauses provided contractual authority to collect a price that, because it had no economic significance to the gas under the contract, was always unjust and unreasonable, that is, not in the public interest. By the same token, section 154.93(b-1) permitted a particular contract clause by which a higher FPC just and reasonable rate could be collected. Since the proposed rate increase was in the public interest, there was no reason to bar use of these escalator clauses. The touchstone, therefore, for application of section 154.93(b-1) is

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provides for petitions for waivers of Commission rules promulgated under the NGA, since it is the exercise of NGA jurisdiction over existing interstate contracts that is to be stayed.

whether the escalation is in the public interest. The question then is whether, with regard to gas remaining within FERC's NGA jurisdiction section, 154.93(b-1) permits area rate clause escalation to higher NGPA rates, rates congressionally prescribed in the public interest.

In Order No. 23, FERC interpreted section 154.93(b)(1) to allow escalation to a higher rate if that rate was (1) regulated, (2) just and reasonable, (3) of general applicability to an area, and (4) applicable to the vintage category of the gas involved. It found the maximum lawful NGPA prices satisfied these criteria. The Commission determined that the public interest policy basis of section 154.93(b-1) and the past practice of flexible application of area rate clauses to collect FPC national and other rates,[44] rather [383] that just area rates as stated in section 154.93(b-1), justified a broader and flexible, rather than literal, interpretation. Therefore, while the regulation's reference to the "Commission" and not to "Congress" may have some importance to the question of the intent of the contracting parties, it did not justify finding that the regulation prevented area rate clause escalation to higher NGPA prices.[45]

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[44] *See* FPC Opinion No. 742, 54 F.P.C. 853, 858 (1975) (small producer gas); FPC Opinion No. 699, 51 F.P.C. 2212 (1974), *aff'd, Shell Oil Co. v. FPC,* 520 F.2d 1061 (5th Cir. 1975), *cert. denied,* 426 U.S. 941, 96 S.Ct. 2661, 49 L.Ed.2d 394 (1976) (rollover contract gas and flowing but undedicated gas).

[45] Similarly, although the regulation specifies "just and reasonable" rates, that literal language cannot serve to prevent area rate clause escalation to NGPA rates. Congress deemed any amount paid in conformity with the strictures of the NGPA to be just and reasonable for purposes of NGA §§ 4 & 5. NGPA § 601(b)(1)(A), 15 U.S.C.A. § 3431(b)(1)(A). Without deciding whether this deemed justness and reasonableness is for all purposes, *see* note 38 *supra,* it is sufficient to note that "just and reasonable" is a term of art in utility regulation generally meaning cost-based rates under the methodology for

With regard to variant clauses that refer to legislatively set rates, FERC concluded that since escalation to congressionally prescribed rates is not contrary to the public interest, it would be entirely consistent with section 154.93(b-1)'s policy to permit such escalation. FERC reasoned that it could not rationally maintain that it is contrary to the public interest for parties to contractually bind themselves to congressional regulatory actions when the FPC had found it appropriate to allow parties to bind themselves to the outcome of proceedings in the exercise of congressionally derived authority.

[10-12] An agency's interpretation of its own regulation is entitled to great deference. *Udall v. Tallman*, 380 U.S. 1, 16, 85 S.Ct. 792, 13 L.Ed.2d 616 (1965). Administrative regulations are to be interpreted broadly and liberally to effectuate their essential purposes. *Baldridge v. Hadley*, 491 F.2d 859, 864 n.2 (10th Cir.), *cert. denied*, 417 U.S. 910, 94 S.Ct. 2608, 41 L.Ed.2d 214 (1974). In light of the policy underlying section 154.93 and the past flexibility in the adaptation of area rate clauses to changes in the regulatory environment, FERC's interpretation that section 154.93(b-1) permits area rate and variant clause escalation to NGPA prices is not plainly erroneous, *United States v. Larionoff*, 431 U.S. 864, 872, 97 S.Ct. 2150, 2155, 53 L.Ed.2d 48 (1977), clearly unreasonable,

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prescribing utility rates that are in the public interest. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944). FPC producer regulation generally used the cost-based ratemaking methodology, but the FPC also prescribed ceiling rates for producers that included incentive-based rates. The regulation's reference should therefore not be tied to the then prevailing ratemaking methodology, but instead to the purpose of that methodology — prescription of rates that are in the public interest. Congressionally established rates are of course prescribed in the public interest, and therefore are within the meaning of "just and reasonable" as used in section 154.93(b-1).

Homan & Crimen, Inc. v. Harris, 626 F.2d 1201, 1208-09 (5th Cir. 1980), or inconsistent with the statute under which it was promulgated, *Larionoff*, 431 U.S. at 873, 97 S.Ct. at 2156.

VI. *CONTRACT LAW TO BE APPLIED IN DETERMINING WHETHER AREA RATE CLAUSES ARE SUFFICIENT CONTRACTUAL AUTHORITY TO COLLECT NGPA PRICES*

[13] In Order No. 23, FERC applied "general principles of contract law" to find that as a general rule area rate clauses could be sufficient contractual authority to collect NGPA prices. It then established protest procedures in which the sufficiency of specific area rate clauses could be determined if contested by the pipeline purchaser or certain third parties. FERC stated it would apply these same general principles of contract law in the protest procedures. This Court affirms the use of general contract law in determining not to preclude area rate clause escalation generally as a matter of contract law, but holds that specific [384] determinations of contractual authority in the protest procedures must take account of and follow any differences with general contract law that the appropriate state contract law may have.[46]

[46]Because of the important federalism issues involved when a federal tribunal applies contract law, this Court raised the issue of which contract law to apply sua sponte at oral argument and requested supplemental briefs on the issue. FERC contends that under NGA § 19(b), 15 U.S.C.A. § 717(b), and NGPA § 506(a)(4), *id.* § 3416(a)(4), this Court lacks jurisdiction to raise the issue itself. Because the parties to this litigation strongly dispute the scope of FERC's jurisdiction to interpret contracts and the correctness of its determination that area rate clauses could be sufficient contractual authority to collect NGPA prices, the issue of what body of law FERC may apply is necessarily raised. This Court therefore has jurisdiction to raise and decide this question.

This holding is a direct result of the application of the doctrine in *Erie Railroad v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188 (1938). The *Erie* decision did not just construe the Rules of Decision Act to include state decisional law in the phrase "law of the several states." It was also a constitutional decision: Because of the unfairness in applying two different, conflicting standards to the same conduct, and the incentive for forum shopping that a differing federal and state rule would create, in a scheme of limited federal and reserved state powers, state substantive law remains the rule of decision unless federal law has preempted that substantive rule. 304 U.S. at 73-78, 58 S.Ct. at 820-822. Nor does *Erie* apply only to federal court diversity jurisdiction.[47] The federalism concern of *Erie* is applicable to every federal tribunal when federal substantive law has not expressly or impliedly displaced the state substantive law on the particular question for decision.

Erie is necessarily implicated in this case because FERC has concurrent jurisdiction with state and federal courts over interpretation of escalation provisions in contracts that remain within FERC's NGA jurisdiction, and because only courts have jurisdiction to interpret escalation provisions in contracts not within FERC's NGA jurisdiction (with the exception of section 105 and 106(b) contracts). The very evil that *Erie* addressed would arise if FERC followed one substantive rule while state courts followed another: parties whose contracts are within concurrent FERC and court jurisdiction would be subject to two different rules for the same conduct, and each would have an

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[47] *First Southern Federal Sav. & Loan Assn' v. First Southern Sav. & Loan Ass'n*, 614 F.2d 71, 73 (5th Cir. 1980); *Maternally Yours, Inc. v. Your Maternity Shop, Inc.*, 234 F.2d 538, 540 n.1 (2d Cir. 1956).

incentive to have their contract interpreted in the forum applying the rule most favorable to that party. *Erie* achieves not uniformity of result, since identical language can carry different contractual intent depending on the circumstances, but instead uniformity of applicable law. No matter which forum the interpretation is made in, the same body of law – either state or federal – would apply.[48]

Neither the NGPA nor the NGA expressly preempt the application of state contract law to the interpretation of gas purchase contracts. The NGA was carefully fashioned to exert federal control only in a limited and well-defined area. It is well-established that contractual claims between parties to a natural gas contract do not arise under the NGA for purposes of federal question jurisdiction of federal courts.[49] The *Mobile-Sierra* doctrine holds that the NGA did not abrogate the ability of the parties to privately contract within the regulatory confines of that Act. NGPA § 101(b)(9) provides the same with respect to the [385] NGPA. Therefore, the federal legislation and regulation of this area does not directly address the interpretation of gas purchase escalation provisions.

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[48]If an issue is controlled by federal law, state courts exercising concurrent jurisdiction are bound by that law. U.S.Const. art. VI, cl. 2; *Free v. Bland*, 369 U.S. 663, 82 S.Ct. 1089, 8 L.Ed.2d 180 (1962).

[49]*Phillips Petroleum Co. v. Texaco, Inc.*, 415 U.S. 125, 94 S.Ct. 1002, 39 L.Ed.2d 209 (1974); *Pan Am. Petroleum Co. v. Superior Court of Delaware*, 366 U.S. 656, 81 S.Ct. 1303, 6 L.Ed.2d 584 (1961); *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667,70 S.Ct. 876, 94 L.Ed. 1194 (1950); *City of New Orleans v. United Gas Pipe Line*, 390 F.Supp. 861 (E.D.La. 1974). Nor does the NGA provide an implied private cause of action for damages against a producer in favor of local distributors and ultimate customers for failure to comply with delivery obligations. *Clark v. Gulf Oil Corp.* 570 F.2d 1138 (3d Cir. 1977), *cert. denied*, 435 U.S. 970, 98 S.Ct. 1611, 56 L.Ed.2d 62 (1978).

[14] That, of course, does not exhaust the analysis since state law can be preempted by "federal common law" even if there can be no "federal general common law."[50] Federal common law arises when the issues involve so strong a federal interest that it is appropriate to resolve them on the basis of uniform decisional federal law rather than varying state laws. One such area concerns federal legislation that fails to direclty address the precise and narrow issue but nevertheless a valid and substantial federal interest or policy requires the application of federal law as an exercise of interstitial lawmaking to protect or to effectuate the federal scheme. *First Southern Federal Savings & Loan Ass'n v. First Southern Savings & Loan Ass'n,* 614 F.2d 71, 73-74 (5th Cir. 1980). If there is a significant conflict between the identifiable federal policy or interest and the use of state law, the state law is preempted. *Miree v.DeKalb County,* 433 U.S. 25, 31, 97 S.Ct. 2490, 2494-2495, 53 L.Ed.2d 557 (1977); *Wallis v. Pan American Petroleum Corp.,* 384 U.S. 63, 68, 86 S.Ct. 1301, 1304, 16 L.Ed.2d 369 (1966).[51] The determination of whether federal common law applies looks to the need for uniformity of result, the federal interest in the regulated subject matter, and the comprehensiveness of that regulation.[52]

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[50]*Clearfield Trust Co. v. United States,* 318 U.S. 363, 63 S.Ct. 573, 87 L.Ed.838 (1943); *Ivy Broadcasting Co. v. AT&T,* 391 F.2d 486 (2d Cir. 1968); C. Wright, The Law of Federal Courts § 60, at 279, 286 (3d ed. 1976); Friendly *In Praise of Erie — and of the New Federal Common Law,* 39 N.Y.U.L.Rev. 383, 405 (1964).

[51]If the issue of escalation clause interpretation is governed by federal common law, that common law would be binding on state and federal courts. *Free v. Bland,* 369 U.S. 663, 82 S.Ct. 1089, 8 L.Ed.2d 180 (1962); *First Southern,* 614 F.2d at 73.

[52]This analysis is the modern or so-called "implied" preemption approach. *See, e.g., Pennsylvania v. Nelson,* 350 U.S. 497, 76 S.Ct. 477, 100 L.Ed. 640 (1956).

[15] That a contract is subject to federal regulation does not by itself demonstrate that Congress intended federal rather than state law govern all aspects of its performance; if the federal interest is sufficiently served by the agency's express regulatory power, it requires some other indication of congressional policy that the contracts should be ruled by uniform federal principles. *Ivy Broadcasting Co. v. AT&T,* 391 F.2d 486, 490 (2d Cir. 1968). The federal scheme of regulation under the NGA and NGPA is limited in its displacement of state regulatory authority. Unlike the Federal Communications Act, in which *Ivy* found federal common law governed contractual disputes involving interstate telephone service, the NGA and NGPA are not so pervasive a scheme of federal regulation as to indicate a congressional objective that cannot be attained without the application of federal common law. *City of New Orleans v. United Gas Pipe Line,* 390 F.Supp. 861, 865-66 (E.D.La. 1974).

[16] Uniformity of result is not assured by the creation of federal common law here. When interpreting escalation clauses, FERC possesses expertise with respect only to technical matters, not with respect to the correct application of the same contract interpretation principles that courts use to fathom the parties' intent. *Compare Texas Gas Transmission Corp. v. Shell Oil Co.,* 363 U.S. 263, 80 S.Ct. 1122, 4 L.Ed.2d 1208 (1960) *and Warren Petroleum Corp. v. FPC,* 282 F.2d 312 (10th Cir. 1960) *with Pure Oil Co. v. FPC,* 299 F.2d 370 (7th Cir. 1962).[53] Since the

[53] *Zachary v. FERC,* 621 F.2d 155 (5th Cir. 1980), *cert. denied,* ____ U.S. ____, 101 S.Ct. 795, 66 L.Ed.2d 611 (1980), is not to the contrary. There FERC was required to decide whether or not the contract at issue was a "replacement contract" and therefore entitled to the more favorable replacement contract rate. This Court stated that the resolution of the issue of rate entitlement necessarily required an inter-

escalation clause's meaning depends on the contracting parties' intentions, which in turn depends on the circumstances of its execution, identical language in different contracts could be interpreted to have different meanings, so even a federal rule of construction would lead to different results. *Kansas Power & Light Co. v. Mesa Petroleum Co.*, No. GP79-4 (FERC Aug. 10, 1979); *Arkansas Louisiana Gas Co. v. Frenk F. Hall*, No. RI 76-28 (FERC May 18, 1979), *petition for review filed*, No. 79-2068 (D.C. Cir. Sept. 10, 1979). Ascertaining the parties' intent is a matter of case-by-case adjudication not susceptible to considerations of uniformity such as exist in a rulemaking proceeding. That area rate clauses were drafted as a result of section 154.93(b-1) does not require that federal common law principles apply to area rate clause interpretation. While FERC has special expertise to interpret the regulation itself, the question of the parties' intent is a dif- [386]

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pretation of the contract, a matter within FERC's special competence. *Id.* at 158. This, however, was in response to an attack on FERC jurisdiction to interpret the contract at all, not whether anything is to be gained by its interpretation rather than by that of some other decider. Nor can the reference in the Supreme Court's *Memphis* case to the "special competence" of the Commission be taken out of its context there to create federal common law here. That reference was in response to whether that case should be remanded to the Court of Appeals for consideration of the contractual authority issue. 358 U.S. at 114, 79 S.Ct. at 200. Because the Supreme Court was satisfied with the Commission's resolution, it found remand to be unnecessary and dilatory. Therefore, the references in *Memphis* and *Zachary* should only be taken to mean that the Commission, in light of its experience in ascertaining contractual authority for rate increase filings, is as competent as a court to make such determinations, and not that the Commission is more competent than courts in this area. Indeed, the Supreme Court in *Memphis* stated that further examination of the record by the Court of Appeals could hardly aid the Supreme Court, and it therefore reviewed the Commission's determination itself. *id.*

ferent matter altogether.[54] Courts can be easily informed of the language, purpose, and history of the regulation when presented with an area rate clause for interpretation. This information is already available in the preambles to the orders here under review. Courts are not any less able to take this into account when construing contracts.

Nor does the federal interest in the subject matter demand the application of federal rules here. The federal concern that the contract price not exceed the applicable ceiling price is adequately protected by FERC's express enforcement authority with respect to maximum lawful prices; section 101(b)(9) permits contractual arrangements to otherwise operate according to their terms. Indeed, this Circuit has specifically rejected the contention that federal common law applies to Commission interpretations of contracts under *Mobile-Sierra; Phillips v. FERC*, 586 F.2d 465 (5th Cir. 1978). The question there was whether nonoperating owners of gas had effectively exercised their contractual right to revoke the lease operator's authorization to sell their gas. FERC applied federal law to find that the owners were bound by the operator's contract with the pipeline though not direct parties to it, and therefore rejected their rate increase filing under NGA § 4. This Court vacated and remanded the Commission decision. FERC's

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[54]Even though the language of a contract may be identical with that of a statute, the contractual language can have a scope independent of the proper construction of the statute. *Skelly Oil Co. v. Phillips Petroleum Co.*, 339 U.S. 667, 678, 70 S.Ct. 876, 882, 94 L.Ed. 1194 (1950). The same words, in different settings, may not mean the same thing; parties do not necessarily endow statutory language in a contract with the scope of the statute, particularly when the same term may have variant meanings for different applications of the statute. *Id.* The same can be said for contracts that draw on regulatory rather than statutory language.

primary concern in these cases is with the integrity of the contractual relationship between the parties, but that does not warrant the erection of an extensive federal common law of contracts in the area of natural gas, nor a more limited federal law to determine which contract governed. 586 F.2d at 469.[55]

Finding that there is no significant conflict between any [387] federal interest and the use of state law in the interpretation of escalation provisions in gas purchase contracts, this Court holds that the appropriate contract law to apply is the law that would govern the parties' dealings were there no regulation at all of the contract's subject matter.[56]

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[55]Furthermore, in *City of New Orleans* the district court refused to find a mandate for federal common law with regard to contractual disputes between pipelines and their curtailed customers over gas supply despite the nationwide natural gas shortage at the time. 390 F.Supp. at 865-66. In *California v. Southland Royalty Co.*, 436 U.S. 519, 98 S.Ct. 1955, 56 L.Ed.2d 505 (1978) (4-3 decision), on the other hand, the federal interest in preventing the loss of gas from the interstate market was decidedly greater and justified overriding state property law on the issue of whether particular acreage remained dedicated to interstate commerce under NGA § 7. *Southland* is also closer to *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392, 400, 85 S.Ct. 1517, 1522, 14 L.Ed.2d 466 (1965), which held that the meaning of the NGA should not be tied down to technical concepts of local law. The issue before FERC in the protest procedures is not, however, the meaning of the statute or a regulation, but instead the meaning of a contract.

[56]The following cases are not contrary to this result: *City of Oglesby v. FERC*, 610 F.2d 897 (D.C.Cir.1979); *Public Service Co. v. FPC*, 557 F.2d 227 (10th Cir. 1977); *Appalachian Power Co. v. FPC*, 529 F.2d 342 (D.C.Cir.), *cert. denied*, 429 U.S. 816, 97 S.Ct. 58, 50 L.Ed.2d 76 (1976); *Richmond Power & Light v. FPC*, 481 F.2d 490 (D.C.Cir.), *cert. denied*, 414 U.S. 1068, 94 S.Ct. 578, 38 L.Ed.2d 473 (1973). In these cases the issue was not whether state contract law applied to the interpretation of the contract, but whether state regulatory law or process concerning ratemaking applied to or was incorporate in the contract.

See Phillips, 586 F.2d at 469 (applying Texas law to issue of contractual authority to file for rate increase under NGA). *See also Premier Resources, Ltd. v. Northern Natural Gas Co.,* 616 F.2d 1171, 1180 (10th Cir.), *cert. denied,* ____ U.S. ____, 101 S.Ct. 92, 66 L.Ed.2d 31 (1980) (applying Oklahoma law to whether a provision constituted an area rate clause); *Sam Rayburn Dam Electric Cooperative v FPC,* 515 F.2d 998, 1009 (D.C.Cir. 1975), *cert. denied,* 426 U.S. 907, 96 S.Ct. 2229, 48 L.Ed.2d 832 (1976) (applying Texas law to issue of contractual authority to file for rate increase under Federal Power Act); *Warren Petroleum,* 282 F.2d at 316 (applying Oklahoma law to question of novation in dispute over FPC interpretation of favored nation clause).[57]

In light of this holding, FERC must take into account, in resolving a particular contractual authority dispute, the law of the state that would apply to its resolution under appropriate choice of law rules. Unlike the substantive contract issue, the determination of which state's contract law applies is properly a matter within federal common law. FERC does not sit in anyone particular state but instead the nation itself is its forum. The interstate nature of this choice of law inquiry makes this matter one essentially federal in character.

FERC need not undertake this determination in every case, however. In the interest of administrative conve-

[57]The issue of whether to apply state or federal law was not reached by the Supreme Couret in *Texas Gas Transmission Corp. v. Shell Oil Co.,* 363 U.S. 263, 80 S.Ct. 1122, 4 L.Ed.2d 1208 (1960), a case in which the FPC had construed a favored nation clause. 363 U.S. at 276, 80 S.Ct. at 1130. On remand, the Third Circuit refused to decide the issue since it held Louisiana law did not differ from general contract doctrine on the issue at hand, so that in either case the result would be the same. *Shell Oil Co. v. FPC,* 292 F.2d 149, 153 (3d Cir.), *cert. denied,* 368 U.S. 915, 82 S.Ct. 195, 7 L.Ed.2d 131 (1961).

nience, it is reasonable to put the burden on the parties to inform FERC if the state law that should apply is any different from the general principles that FERC utilizes. This frees the Commission from the burden of determining the proper choice of state contract law in every case. Since the Uniform Commercial Code applies to natural gas sales as the sale of goods, U.C.C. § 2-107(1), and all states except Louisiana have adopted the UCC, variations between state law and general principles are likely to be few. When such differences appear, however, FERC must follow the state law. The orders below are thus modified accordingly.

VII. *FERC APPLICATION OF GENERAL PRINCIPLES OF CONTRACT LAW*

FERC determined that it was not an unreasonable interpretation of the parties' intent to conclude that as a [388] general rule area rate clauses were sufficient authority to collect NGPA prices. FERC would thus not interpose any general objection to the parties ascribing an interpretation to area rate clauses as contractual authority to collect NGPA prices, leaving the specific determination to be handled case-by-case in the protest procedures.

[17] When interpreting a contract, the question is what was the parties' intent, since courts are compelled to give effect to the parties' intentions. *Western Beef, Inc. v. Compton Investment Co.*, 611 F.2d 587, 592 (5th Cir. 1980). To determine this intent, the court must put itself in the position of the parties by considering the instrument itself, its purposes, and the circumstances of its execution and performance. *See Superior Oil Co. v. Western Slope Gas Co.*, 604 F.2d 1281, 1288-89 (10th Cir. 1979). In short, the court looks to the language of the contract and its commercial (or in this case, regulatory) context.

U.C.C. § 1-205, Official Comment, 1, § 2-202 & Official Comment 1 & 2. *See Chase Manhattan Bank v. First Marion Bank,* 437 F.2d 1040, 1046 (5th Cir. 1971).

[18, 19] Consumers contend, in reliance on the parol evidence rule, that when the language is plain and unambiguous, the parties' intention must be discerned solely from the contract language without resort to extrinsic evidence. They then assert that since there is no ambiguity on the face of area rate clauses, consideration of the commercial context is inappropriate. This position is a misapplication of the parol evidence rule and has been expressly rejected by the UCC. U.C.C. § 1-205, Official Comment 1, § 2-202, Official Comment 1(b) & (c). The test is whether the extrinsic evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible; the "plain meaning" position of the Consumers ignores the parties' intentions or presumes "a degree of verbal precision presently unattainable by our language." *Lucie v. Kleen-Lee, Inc.* 499 F.2d 220, 221 (7th Cir. 1974).

[20] The parol evidence rule excludes extrinsic evidence offered to vary or contradict, rather than to explain and interpret, the terms of an integrated contract. 3 A. Corbin, Corbin on Contracts § 543, at 130 (1960). It is only after consideration of the extrinsic evidence that the parol evidence rule applies – if in light of the circumstances and purposes of the contract the court finds it unambiguous and integrated, parol evidence of a party's subjective intentions cannot be used to change the contract's meaning. *Lucie v. Kleen-Leen, Inc.,* 499 F.2d at 221; *Chase Manhattan,* 437 F.2d at 1048; 3 A. Corbin, *supra,* § 543, at 130-31, § 579, at 412-13. In other words, since perception is conditioned by environment, it is proper to consider the contract's commercial setting even though the contract is

not facially ambiguous. *Chase Manhattan,* 437 F.2d at 1046. Furthermore, ambiguity often arises from the application of the contract to the subject matter of the agreement, and extrinsic evidence is admissible to remove and explain any ambiguity in the contract as applied. *Sunburry Textile Mills, Inc. v. C.I.R.,* 585 F.2d 1190, 1196 (3d Cir. 1978). Ambiguity easily arises when the contract is applied to its subject matter in changed circumstances. Area rate clauses are certainly ambiguous as applied to the collection of currently available ceiling rates for natural gas. A contract should be interpreted in light of the changed circumstances to accomplish what the parties intended. *See Richmond Power & Light v. FPC,* 481 F.2d 490, 499 (D.C. Cir.), *cert. denied,* 414 U.S. 1068, 94 S.Ct. 578, 38 L.Ed.2d 473 (1973).[58]

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[58]Consumers also cite in support of their position *J.M. Huber Corp. v. Denman,* 367 F.2d 104, 109 (5th Cir. 1966), and *Texas Eastern Transmission Co. v. FPC,* 306 F.2d 345, 347-48 (5th Cir. 1962), *cert. denied,* 375 U.S. 941, 84 S.Ct. 347, 11 L.Ed.2d 273 (1963). These two cases cut against rather than support the Consumers' position. Both cases state that when construing a contract, the court is to put itself in the position of the parties. In *Texas Eastern* this meant that the agreement must be read in the setting of the NGA. This Court then looked to the circumstances of the execution of the gas rate settlement there and found that because of the close scrutiny with which the FPC gave such proposed settlements before giving its approval thereto, the settlement language had been crafted with almost certain precision and the parties should be bound thereby. In *Huber,* this Court thought that there was ample evidence to justify the conclusion that the parties' use of terms well-recognized in oil and gas law should be given their literal meaning. It was only after considering contextual matters that the Court found it reasonable to ascribe to the parties' intentions the literal meaning of their language.

Harrison v. FERC, 567 F.2d 308, 310 (5th Cir. 1978), is not to the contrary. This Court stated that in interpreting the document there, plain meaning controls absent ambiguity or special usage. Aside from the fact that *Harrison* involved construction of an FPC certificate of public convenience and necessity rather than a private contract, this cryptic statement permits the use of the commercial context since

[21] FERC determined that given the regulatory environment prevailing under the NGA, the flexible application of area rate clauses to collect national and incentive ceiling rates, and the substantial agreement among the contracting parties as to the meaning of area rate clauses, a strict, literal interpretation of the clauses was inappropriate. This Court holds that FERC reasonably concluded that area rate clauses, even those that literally track section 154.93(b-1), could constitute sufficient authority to collect NGPA prices, subject to specific protests by pipelines or third parties. FERC reasonably concluded from the contract language and its regulatory and commercial context that it was not unreasonable for the parties to have meant to contract for whatever regulated rate was available, and not necessarily to have intended to limit the *source* of those ceilings.[59] FERC properly limited its con- [389]

"special usage" is just one such matter. *See* U.C.C. § 2-202(a) (permitting evidence of "usage of trade" to explain contract).

Despite Consumers' contentions, *Louisiana Power & Light Co. v. FERC*, 587 F.2d 671, 675 (5th Cir. 1979), is also not supportive of their view. There this Court said that if the parties had in fact agreed to give the utility the right to file unilateral rate changes, the contracts should have stated as much in unambiguous terms, rather than leave such an important right to implication. In this case, the parties expressly provided for the seller's right to file unilateral rate changes — the area rate clause. The question presented in this case is what sort of rate that provision can include in light of the changed circumstances.

[59] *See* U.C.C. §§ 1-205(4) & 2-208(2). These provide that the express terms of the agreement and any course of performance, course of dealing, and usage of trade shall be construed whenever reasonable as consistent with each other. If such a construction is unreasonable, express terms control course of performance, and course of performance shall control course of dealing and usage of trade. In this case, the contractual provisions for escalation to the federal ceiling rates prescribed by the FPC may reasonably be construed consistently with the subsequent flexible use of area rate clauses to collect the highest ceiling price the FPC legally permitted with the advent of national ceiling rates and incentive ratemaking. This consistent construction may

clusion to a general and not conclusive rule in light of the reality that, since it is a question of the parties' intent, this conclusion may not be the case for every contract: One pipeline asserted that it intended for the price to escalate to a rate set after agency proceedings, safeguarded by adversary participation and opportunity for judicial review. The protest procedure permits the airing of interpretive differences such as these.[60] In light of the changed circumstances brought about by the enactment of the NGPA, it was reasonable for FERC to provide for the opportunity to interpret area rate and variant escalation [390] clauses to accomplish what the parties intended rather than to categorically interpret them literally to the defeat of this intent.

VIII. *FERC PROTEST PROCEDURES*

[22, 23] It was within FERC discretion to implement its NGA § 4 authority by adopting the protest procedures in

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result in a reasonable interpretation that the parties meant to make pricing a matter tied to governmental decision whenever the government chose to act.

[60]Much of the dispute over the application of contract law concerns variant escalation clauses. Many of these variants provided the additional language "other governmental authority" or "successor governmental authority" concerning prices prescribed by the "Commission." It is clear that Congress is a governmental authority with the power to prescribe ceiling rates of general applicability that are in the public interest, and that it is an "other" governmental authority. Since Congress delegated its ratemaking authority to the FPC and then reassumed that ratemaking function with the enactment of the NGPA, Congress is not the delegatee of the FPC. It is, however, its successor, since a successor is one who follows or take the place of another in the sense of serial replacement, so that a delegator can succeed or replace its delegatee. Whether the use of "successor" was so intended to include Congress, however, depends on how the parties used that term in the contract.

Order No. 23-B. Because the NGA § 4 filing requirement pertains only to interstate contracts for gas still subject to FERC's NGA jurisdiction, the protest procedures were of course properly limited to assertions of contractual authority to collect NGPA §§ 104, 106(a), 108, and 109(a)(2) prices by means of an interstate contract area rate or variant clause.[61] The real battle here is not over the

[61]Consumers argue that FERC improperly limited its protest procedures to gas remaining within the NGA. This argument proceeds on its interpretation that NGPA § 101(b)(9) gives FERC enforcement authority with regard to contract price violations that do not implicate the NGPA ceilings. As this opinion made clear in Part III, the Consumers' position in this regard is meritless. This Court holds that FERC properly limited its protest procedure to contracts covering gas for which the NGA § 4 filing requirement remains applicable.

With respect to existing intrastate contracts, FERC has jurisdiction to interpret escalation provisions to the extent that it must do so to determine the maximum lawful § 105 and § 106(b) price. Because there is no filing requirement to collect these prices, FERC is not required to address the issue of contract interpretation when asked to do so. The same is true for those enjoying "small producer" status and thus under 18 C.F.R. § 157.40 may raise rates to ceiling levels without filing rate schedules (contracts) or make rate increase filings, even though the gas sales are subject to NGA regulation. *See Arkansas Louisiana v. Frank F. Hall*, No. RI 76-28 (FERC May 18, 1979), *petition for review filed*, No. 79-2068 (D.C.Cir. Sept. 10, 1979). FERC declared in Order No. 23 and Order on Rehearing of Order No. 23 that it would leave any intrastate contract interpretation questions to the parties and state and federal courts. *See also Kansas Power & Light Co. v. Mesa Petroleum Co.*, No. GP79-4 (FERC Aug. 10, 1979) (order dismissing petition for declaratory order with regard to proper interpretation of intrastate contract escalation provision covering gas priced under § 105(b)(1)).

decision to adopt protest procedures,[62] but instead all parties complain about the reasonableness of the exercise of that discretion in the actual design of the procedures.[63]

[24] Producers contend that FERC unlawfully placed the burden of proof on sellers to show specific contractual authority in cases of pipeline protests. This argument is based on their initial premise that there is a conclusive presumption that area rate clauses are sufficient contractual authority to collect ceiling prices of general applicability such as NGPA prices. They reason that the producer should not be made to prove what is already conclusively presumed to exist. There is no conclusive presumption, however, since the question is what was the

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[62]Producers do contest the authority of FERC to adopt the protest procedure in Order No. 23-B. The argument for this lack of authority is that FERC unlawfully repealed a conclusive presumption that area rate clauses are sufficient contractual authority to collect ceiling prices of general applicability such as NGPA prices. While there may have been a conclusive presumption that area rate clauses were sufficient authority to collect NGA ceiling prices, it does not necessarily follow that it is sufficient authority to collect NGPA prices, since the question is whether the parties intended to collect the highest available regulated price or a more narrow intent looking to FPC rate proceedings. Although FERC found area rate clauses could be sufficient authority as a general rule, it is only a general rule, and the outcome properly depends upon the particular contract, its commercial and regulatory context, and the application of substantive contract law. Therefore, no conclusive presumption was unlawfully repealed.

[63]This Court has already disposed of the issue concerning the reasonableness of FERC's inclusion within the scope of the protest procedures of gas under an interstate contract awaiting the final outcome of a pending eligibility determination that would result in removal of that gas from NGA jurisdiction. *See* note 43 and accompanying text *supra*.

parties' intent relative to the scope of the contractual clause. This determination depends on the actual language of the clause, the commercial and regulatory context, and substantive contract law. Since it is the producer who must have contractual authority to make the rate increase filing, the Commissioner properly allocated the burden of proof in cases of pipeline protests.

[25] Producers also contend the FERC illegally allowed [391] third party protestors to contest the pipeline and producer's mutual interpetation that the area rate clause provides sufficient contractual authority to collect NGPA prices. The third parties that FERC allowed to protest the parties' assertions are consumers and those representing their interests: the FERC Staff, state regulatory commissions, local distribution companies, and consumer groups. The Producers reason that the only standing these strangers to the contract have is to contest the justness and reasonableness of rates proposed in the rate increase filing. Because congressional prescription of the NGPA ceiling rates eliminates the issue of the lawfulness of the rate increase, only pipelines, not third parties, would, under Producers' position, have standing on the contract interpretation issue.

Concepts of administrative standing are not congruent with article III case or controversy standing requirements. *Gardner v. FCC*, 530 F.2d 1086, 1090-91 (D.C.Cir. 1976). *Accord, Koniag, Inc., Village of Uyak v. Andrus*, 580 F.2d 601,611-17 (D.C.Cir.1978) (Bazelon, J., concurring), *cert. denied*, 439 U.S. 1052, 99 S.Ct. 733, 58 L.Ed.2d 712 (1978). In the context of agency responsibility for implementation of statutory goals, a requirement of privity to raise a protest is much too narrow. Pipeline customers are parties in interest, even though not actual parties to the contract, because it is they who must ultimately bear the

cost of any higher prices.[64] Third party protestors therefore meet the standing requirement of 5 U.S.C.A. § 555(b) to lodge a protest with the Commission over the contracting parties' assertion of contractual authority. Section 555(b) provides that an interested person may appear before an agency for the presentation, adjustment, or determination of an issue, request, or controversy in a proceeding, whether interlocutory, summary, or otherwise, or in connection with an agency function. Because FERC must determine whether there is contractual authority when presented with a rate increase filing, the protest by third parties is in the nature of an intervention in an already existing proceeding, and not the initiation of a contract action against the parties to the contract. In this administrative context there is no impropriety in granting third parties standing to protest the contracting parties' interpretation.[65]

In recognition, however, that third parties are indeed strangers to the contract, their standing to protest carries certain procedural restraints that a pipeline protestor does not bear. Consumers contest the reasonableness of these procedural restraints. They claim that the protest pro-

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[64]Under NGPA § 601(c), interstate pipelines are guaranteed passthrough of NGPA prices except in cases of fraud or abuse. State regulatory commissions, consumer groups, and the FERC Staff, organizations with consumer protection responsibilities, have as much of an interest as actual consumers in the issue of contractual authority.

[65]*Cf. Memphis Light, Gas & Water Division v. FPC*, 250 F.2d 402, 404 (D.C.Cir.1957), *rev'd on other grounds sub nom. United Gas Pipe Line Co. v. Memphis Light, Gas & Water Division*, 358 U.S. 103, 79 S.Ct. 194, 3 L.Ed.2d 153 (1958) (stranger to contract was aggrieved within meaning of NGA § 19(b) for purpose of judicial review when that stranger, a purchaser from a direct customer of the seller, had agreement with direct customer to reimburse that customer for any cost increase from approval of the seller's rate increase).

cedures are a shame because they give no real opportunity for a fair and informed adjudication of the protest in violation of fifth amendment procedural due process.

[26] Consumers allege that they bear an unreasonable burden in having to come forward with substantial evidence to rebut the reasonableness of the parties' mutual interpretation. However, when the parties are in agreement on the meaning of their contract, that mutual interpretation is entitled to considerable weight since the parties know best what they meant by their words of agreement. *See Sunbury Textile Mills, Inc. v. C.I.R.*, 585 F.2d 1190, 1196 (3d Cir. 1978); *United States v. F.D. Rich Co.*, 434 F.2d 855, 859 (9th Cir. 1970); *Louisiana-Nevada Transit Co. v. Woods*, 393 F.Supp. 177, 184 (W.D.Ark.1975); U.C.C. § 2-208, Official Comment 1. Indeed, when the [392] "harmonious recital" of the contract's meaning is supported by extrinsic evidence, it has been said to be conclusive despite the assertions of one not a party to the contract but having an interest in its underlying transaction. *Sunbury*, 585 F.2d at 1196.[66]

[27] Thus, it is proper to provide a rebuttable presumption in favor of the parties' interpretation as a matter of contract law. Nor is such a presumption violative of due process. Rebuttable presumptions serve as burden-shift-

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[66]Consumers cite *United States v. Ivey*, 414 F.2d 199, 203 (5th Cir. 1969), to the effect that this Circuit takes a position opposite to that in *Sunbury*. This assertion is in error. *Ivey* held that the parol evidence rule applies not only to disputes between the parties over a contract's meaning, but also when a party asserts a subjective intent that contradicts the contract in a dispute with one not a party to the contract but having an interest in its underlying transaction. It is thus in full accord with *Sunbury* since under the parol evidence rule extrinsic evidence can explain, but not contradict, the contract when there is no facial ambiguity.

ing devices, allowing the government to efficiently act on an individualized basis when so required by due process. *See United States Department of Agriculture v. Murry*, 413 U.S. 508, 518, 93 S.Ct. 2832, 2838, 37 L.Ed.2d 767 (1973) (Marshall, J., concurring).[67] This brings us to the next contention.

Consumers argue that FERC has effectively made its presumption conclusive because it prejudged the only evidence the protestors easily have available – the language of the area rate clause itself. They claim that they lack the resources to discover evidence in producer and pipeline files. They argue that the inability to find other language in the contract or other evidence negating the conclusion of contractual authority prevents them from discharging their burden of production necessary to overcome the presumption in favor of the parties' interpretation and receive a hearing. This argument must fail. To begin, protestors do have available upon specific request not only copies of the pipeline's evidentiary submission containing the area rate clause, but in addition the entire contract is available

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[67]The lack of a rebuttable presumption obstacle for pipeline protestors does not violate the equal protection element of fifth amendment due process. For economic regulation, the equal protection test is a rational relationship between the means and the end. *See, e.g., Dandrige v. Williams*, 397 U.S. 471, 90 S.Ct. 1153, 25 L.Ed.2d 491 (1970). This deferential standard of review is satisfied in this case. First, if the parties cannot agree, there is no presumption that must be overcome. Second, the difference in procedural burden for protestors to reach a hearing is further justified by the different nature of the protestors and the different interests that they have. The pipeline, as a direct party to an ongoing relationship, is not likely to protest unless it has good reason to do so. Third parties, on the other hand, have greater incentive to file protests with little or no merit so as to delay contractual escalation. Therefore, the difference in procedural burdens is a reasonable means to achieve the end of preventing third party abuse of the protest procedures.

both in FERC's files and the public files of each natural gas company. Secondly, the protestors are properly given the burden of any additional discovery at their expense since they are challenging the parties' interpretation. The presumption in favor of that interpretation is the same as that which arises from a prima facie case: it imposes on the party against whom it is directed the burden of going forward with substantial evidence to rebut or meet the presumption, but does not shift the burden of persuasion. Therefore, protestors need not prove the lack of contractual authority, but only produce some evidence to the contrary. *See* Fed.R.Evid.301.

The Consumers' assertion that a hearing imposes the financial burden on them of finding the witnesses who actually negotiated the particular area rate clauses, so as to determine the intent of the parties, is meritless because the producer and pipeline bear the burden of persuasion by a preponderance of the evidence once the protestor survives summary dismissal and receives a hearing. Furthermore, the language of the contract, its commercial context, and other probative extrinsic evidence may suffice without the testimony of those who negotiated the contracts. This Court thus concludes that the protest procedures do not [393] deprive third party protestors of procedural due process.[68]

[68]Nor do the protest procedures violate the Administrative Procedure Act. NGA § 4 requires a hearing on the justness and reasonableness of a proposed rate, not on the ancillary jurisdiction question of contractual authority. An APA-type hearing applies only when the enabling or organic statute requires an adjudication on the record after opportunity for an agency hearing. 5 U.S.C.A. § 554(a). Therefore, the procedural obstacle for third parties to overcome to receive a hearing does not violate the APA.

IX. *CONTRACT AMENDMENTS*

In Order No. 23-A the Commission determined that parties were free to amend or modify their contracts to provide for the collection of NGPA prices, and would not define in a rulemaking any general standards for pipeline passthrough of NGPA prices that result from a contract amendment. The NGPA precludes pipeline guaranteed passthrough of NGPA prices when FERC determines that the amounts paid are excessive due to fraud, abuse, or similar grounds.

[28] With regard to contractual amendments as sufficient authority for ceiling rate collection, FERC declined the Consumers' request that it require the parties make an evidentiary submission of the amendment similar to the submission required in Order No. 23-B. Consumers contend that fraud, abuse, or lack of consideration in the creation of the amendment is a matter that goes to contractual authority and that this should properly be within the Order 23-B protest procedures. The Commission, however, refused to so inject itself into the amendment process. This was entirely proper. The parties remain free to contract within the parameters of the NGPA ceiling price structure, therefore they can freely amend their contracts to collect NGPA prices. Whether the amendment is valid is a matter of substantive contract law — an issue separate and independent of the regulatory issue of whether a pipeline may pass through increased costs from an amendment. For gas still subject to the NGA § 4 filing requirements, FERC can determine whether the amendment is sufficient authority to file for the rate increase. For gas not subject to NGA § 4, it is for state or federal

courts to resolve disputes concerning the validity of an amendment.[69]

[29, 30] It was also proper for FERC not to promulgate general standards for pipeline passthrough of NGPA prices pursuant to contractual amendments, but rather to leave the determination of whether the amounts paid are excessive because of fraud, abuse, or similar grounds, to case-by-case review in each pipeline's purchased gas adjustment proceeding. It is within an agency's discretion to determine which enforcement methods – rulemaking, adjudication, or a combination of both – are most appropriate. *NAACP v. FPC*, 425 U.S. 662, 668, 96 S.Ct. 1806, 1810-1811, 48 L.Ed.2d 284 (1976). FERC reasonably exercised this discretion given the difficulty in defining which facts constitute fraud or abuse. It always re- [394]

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[69]Order No. 23-A and the Order on Rehearing of Order No. 23-A did not address the issue of how the contractual amendment may be made. In the Notice of Proposed Rulemaking FERC indicated that a contractual modification was to be evidenced by a "contract amendment or separate letter agreement." FERC did recognize in Order No. 23-B that the parties' subsequent conduct can modify the original terms of a contract. *See Louisiana Power & Light Co. v. FERC*, 578 F.2d 671, 676 (5th Cir. 1979); *Sam Rayburn Dam Elec. Coop. v. FPC*, 515 F.2d 998, 1007, 1009 (D.C.Cir.1975), *cert. denied*, 426 U.S. 907, 96 S.Ct. 2229, 48 L.Ed.2d 832 (1976). Such a modification can occur if the buyer unconditionally pays the higher price requested by the seller. *See Southern Natural Gas Co. v. FPC*, 361 F.2d 70, 70 (D.C.Cir.1966). The pipeline's concurrence in the producer's assertion that the area rate clause is sufficient contractual authority to collect NGPA prices may in some cases also constitute an amendment to the existing contract to pay those rates, rather than simply an interpretation of the original contract. *See* U.C.C. § 2-208(3) & Official Comment 3. These issues are properly left to be resolved in specific cases.

FERC expressly left open the issue of retroactive operation of express amendments in both Order No. 23 and the Order on Rehearing of Order No. 23-A. This Court refuses to pass on this issue at this time and leaves it for FERC to address in the first instance.

mains free to initiate a rulemaking on the issue of passthrough preclusion if after experience it finds the task can be more suitably addressed generically.

X. *CONCLUSION*

Faced with a monumental task not foreseen by Congress, FERC had to resolve the contractual authority issue as efficiently as possible. The orders under review here represent a reasonable approach to FERC's responsibility. In such cases, this Court is most hesitant to invalidate FERC's efforts. Because the orders do not violate the NGPA or the NGA, and are for the most part not arbitrary, capricious, an abuse of discretion, irrational, or unreasonable, they are in the main upheld.

AFFIRMED IN PART, SET ASIDE IN PART, AND MODIFIED IN PART.

APPENDIX B

1

TITLE 18 – CONSERVATION OF POWER AND WATER RESOURCES

CHAPTER I – FEDERAL ENERGY REGULATORY COMMISSION

[Docket No. RM79-3]

* * * *

INTERIM REGULATIONS IMPLEMENTING THE NATURAL GAS POLICY ACT OF 1978

* * * *

I. INTRODUCTION

On November 9, 1978, the Natural Gas Policy Act of 1978 (NGPA) was signed into law. By passage of the NGPA, Congress has mandated a new legislative framework for the regulation of most facets of the natural gas industry. The new law affects sales, transmission and distribution of natural gas. The previously controlling federal regulatory statute, the Natural Gas Act (NGA) has in many respects been limited, replaced or superseded by the NGPA, although it continues to be of significance with respect to gas previously dedicated to interstate commerce. merce. [E.R. 1594]

A primary effect of the NGPA is the substitution of a series of specific statutory maximum price levels applicable to discrete types of "first sales" of natural gas for the previously established system of price regulation of interstate sales of natural gas which had been grounded in a

cost-based methodology. An important distinction between producer regulation under the NGA and the NGPA is the expansion of the Federal Energy Regulatgory Commission's (Commission) jurisdictional scope to encompass not only sales made in interstate commerce but in intrastate commerce as well. Under the NGPA, all first sales of natural gas are controlled by the maximum statutory ceiling rates and as a result, it is unlawful for any person to sell natural gas at a price in excess of the statutory maximum regardless of whether the sale occurs in the inter- or intrastate market. [E.R. 15

The Commission wishes to call specific attention to the provisions of section 101(b)(9) of the NGPA. The Congress, by that provision, emphasizes and makes clear that the maximum lawful prices under the NGPA are *ceiling* prices and do not supersede or nullify the effectiveness of any contractual agreement to pay a lower price. Therefore, the Commission cautions producers not to assume entitlement to any NGPA ceiling price which is higher than their contract prices.

The Commission is directed to administer essentially all of the NGPA and is authorized to perform any and all acts and to prescribe and issue such rules and orders as it finds necessary or appropriate to carry out its functions under the NGPA. On November 13, 1978, the Commission proposed interim regulations as the first step in implementing the NGPA. These interim regulations, contained in this notice, mark the second step in carrying out the basic responsibilities for implementation and administration of the Act and provide a mechanism for transition from the NGA regulating regime to the NGPA scheme.

The NGPA is divided into six titles: [E.R. 15

I. Pricing
   A. Price Controls Applicable to Sales of Natural Gas
   B. Decontrol of Certain Natural Gas Prices

II. Incremental Pricing

III. Additional Authorities and Requirements
   A. Emergency Authorities
   B. Other Authorities and Requirements

IV. Natural Gas Curtailment Policies

V. Administration, Enforcement, and Review

VI. Coordination with the Natural Gas Act, Effect on State Laws

The interim regulations prescribed here do not implement all titles under the NGPA. Rather, the regulations propose to deal with those areas demanding the most expeditious treatment.

This first group of regulations is designed to set in motion the new scheme for pricing of first sales of natural gas and to provide mechanism for implementation of provisions of the NGPA covering certain arrangements for transportation of natural gas. However, before setting out in detail a full description of the specific regulations proposed, a summary of the most salient features of the NGPA, the effect on regulation under the NGA, and a capsule description of the implementing regulations and corollary modifications of regulations under the NGA, may be useful. [E.R. 1597]

THE LEGISLATIVE SCHEME OF THE NGPA

The nature and scope of Commission regulation of producer sales under the NGPA has been substantially

transformed from utility-type regulation of a limited market to what is essentially price regulation of an entire national market. Under the scheme set up by the NGPA, there exist two major categories of first sales: those requiring a prior determination of eligibility to be made by a jurisdictional federal or state agency (within the meaning of the NGPA) before collection of the maximum lawful price and those not explicitly requiring such a determination. A decision as to whether a first sale falls into a category requiring a determination is fundamental. A decision to seek a determination triggers quite different regulatory consequences than a decision not to seek a determination. [E.

Although under certain provisions the Commission may be called upon to return to the cost-based, just and reasonable methodology within the meaning of the NGA in establishing rates in excess of the NGPA ceiling prices, the basic administration of the pricing provisions of the NGPA will be undertaken from an entirely different perspective. The Commission will no longer inquire into producer costs or set permissible rates of return for producers. Instead, the Commission's focus will center on whether geological information, production history, field records, prior contractual relationships and information of a similar nature support the categorization for pricing purposes claimed by producers. [E.R. 1

Another crucial factor in anticipating what regulatory treatment will be accorded producer sales of natural gas is whether gas is "committed or dedicated" for purposes of NGA regulation. The limitations on NGA regulation as a result of enactment of the NGPA will be addressed in another section of this preamble. However, the distinction between gas which is deemed to be subject to continuing

regulation under the NGA and gas which falls solely within the NGPA regulatory format is significant and affects both pricing and nonpricing regulation of producer matters.

For categories of gas requiring a prior determination by a federal or state agency, the Commission's function is more in the nature of an appellate body, reviewing, on a substantial evidence basis, the factual determinations of the appropriate jurisdictional agency with the right of disapproval in the event the initial determination is not adequately substantiated. The Commission rules reflect this role and prescribe the basic and minimum factual foundation necessary to meet its review responsibilities without directly interposing the Commission into the procedural functioning of the jurisdictional agency. The review process of initial determinations begins when notice is received of a jurisdictional agency's determination with the appropriate supporting material specified in Part 274 of the proposed regulations. In the absence of a reversal, the determination of the jurisdictional agency becomes final and no longer subject to review unless based on any untrue statement of material fact or upon any omission of material fact which omission was misleading. [E.R. 1599]

Categories of first sales explicitly requiring that a determination as to qualification to collect the maximum lawful price be made by either a jurisdictional federal or state agency are:

- section 102 which sets a maximum lawful price for first sales of new natural gas (gas produced from a new lease on the Outer Continental Shelf (OCS) or certain new onshore wells) and gas produced from any old OCS lease which was from a reservoir discovered after July 27, 1976;

—Section 103 which sets a maximum price for first sales of new onshore production wells; [E.R. 1600]

—Section 107 which sets a maximum lawful price for first sales of high-cost natural gas including gas produced from geopressurized brine, coal seams, Devonian shale or gas produced under other conditions the FERC determines to present "extraordinary" risks or costs; and

—Section 108 which sets the maximum lawful price for first sales of stripper well natural gas.

An essential element in the regulatory system established with respect to categories requiring a prior determination is the provision for interim collection procedures by producers awaiting a final determination or the outcome of a review of such determination. The Commission has a concomitant power to require refunds from the producer if the gas eventually qualifies for a lower price. Section 503(e) sets out this collection and refunding procedure.

Part 273 of the regulations states the prerequisites for interim collection. First, the Commission has established a "transitional rule" to permit the collection by producers of the section 109 price if a producer files for a determination by March 1, 1979. Additional rules are established for interim collection pending and following a state or federal agency determination.

Those first sales of natural gas not requiring a prior determination to be made by a jurisdictional federal or state agency are tied to previously existing contractually set prices or price levels established by the Federal Power Commission or this Commission. First sales not requiring a prior determination under the NGPA are: [E.R. 16

- section 104 which incorporates by reference the just and reasonable rates established under the NGA for first sales of gas committed or dedicated to interstate commerce on the day before the date of enactment of the NGPA;

- section 105 which establishes maximum lawful prices for first sales under existing contracts of natural gas not previously committed or dedicated to interstate commerce;

- section 106 which establishes maximum lawful prices for first sales under interstate and intrastate rollover contracts; and

- section 109 which establishes the maximum lawful price for first sales of natural gas from the Prudhoe Bay in Alaska and categories of gas not otherwise covered by other sections of the NGPA. [E.R. 1602]

The Commission has general administrative and enforcement authority under the NGPA and the NGA to order refunds in cases where the maximum lawful price level has been improperly exceeded.

EFFECT OF THE NGPA UPON CONTINUED NGA REGULATION

Natural gas which remains committed or dedicated to interstate commerce on the day before the date of enactment of the NGPA, or which is not specifically exempted from the jurisdictional consequences of commitment or dedication by the NGPA, remains subject to all the non-price regulatory requirements of the NGA. An important aspect of continued NGA regulation is the requirement that a producer file an abandonment application with the FERC pursuant to section 7(b) of the NGA before ter-

minating service to the interstate market or before abandonment of facilities used to render interstate service. Additionally, although price regulation of first sales by producers of gas committed or dedicated is now governed by the NGPA, sections 104 and 106(a) are grounded in previously established rates under the NGA. As a result, producers wishing to establish their right to collect under these sections will be required to make a filing under their rate schedules under the NGA. The Commission has [E.R. 160
amended its previously existing filing requirements to provide new procedures governing these rate increase filings.

If gas is not committed or dedicated to interstate commerce as defined in section 2(18) or is exempted from the jurisdiction of the NGA under section 601(a)(1)(B) as high cost natural gas, new natural gas, or natural gas produced from any new onshore production well, the prior framework of utility-type regulation under the NGA no longer applies.

If natural gas sales are freed from the requirements of the NGA, several adjuncts to NGA regulation are obviated. First, there is no longer any necessity for a producer to seek certification of the sale as serving the public convenience and necessity. The replacement for this requirement under the NGPA is limited to the prior determination mechanism, where applicable, and the pricing limits established in the NGPA. New sales of such gas in interstate commerce no longer require certification as a prerequisite to commencement of deliveries. Nor does the requirement for abandonment authorization before termination of deliveries of natural gas exist with respect to natural gas no longer subject to NGA regulation. In the [E.R. 16
case of first sales of natural gas not previously committed or dedicated to interstate commerce or exempted from NGA regulation, tariff filings and rate increase applica-

tions are dispensed with. (Of course, specific requirements for filing to establish the right to collect the maximum lawful price levels exist under the regulations and annual reporting will be required under the NGPA in many instances. However, the nature of these filings, which are in many cases one-time notification type filings is quite different from the rate filings previouisly required under the NGA.)

For natural gas which on the date of enactment was committed or dedicated but which is exempted from the NGA under section 601(a)(1) of the NGPA, there are substitute mechanisms for NGA section 7(b) abandonment authorization. These substitute provisions, intended to provide a degree of certainty to purchasers dependent upon a predictable natural gas supply, are found in section 315 of the NGPA. The Commission has not attempted to implement these sections in the initial implementing regulations. It is our intent to do so in the near future. That section gives the Commission dual authority to establish by rule or order the minimum duration of any [E.R. 1605] contract (other than an existing contract) for the purchase of natural gas and to require by rule the right of first refusal with respect to any gas committed or dedicated to interstate commerce before the date of enactment if such gas is high cost gas, new natural gas or natural gas produced from any new, onshore production well.

Indirectly, NGA regulation is affected by the operation of section 601(b) and (c) of the NGPA. Section 601(b) provides that any amount paid in any first sale of natural gas shall be deemed to be just and resasonable if such amount does not exceed the maximum lawful ceilings established by the NGPA or if there is no maximum lawful price applicable by reason of elimination of price controls. Section 601(c), the guaranteed passthrough provision, states that

the Commission may not deny, or condition, the grant of any certificate under section 7 of the NGA based upon the amount paid in any sale of natural gas if the amount paid meets the standards of section 601(b) and is, therefore, by statutory fiat, just and reasonable. Additionally, the Commission may only deny the recovery by any interstate pipeline of any amount paid with respect to the purchase of natural gas under section 601(b) to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

Finally, included in the implementing regulations are provisions covering certain transportation arrangements by both interstate and intrastate pipelines. Provision is made for intrastate pipeline sales and for the assignment of natural gas excess to their requirements. Also, the Commission has revised its regulations previously applicable to emergency transactions and revised the procedure and the standards for emergency sales of natural gas for this winter's heating season.

GENERAL OUTLINE OF IMPLEMENTING REGULATIONS

The interim regulations add two new subchapters to the Commission's regulations in Chapter 1 of Title 18. New Subchapter H (Parts 270 through 276) contains the new producer regulations under the NGPA. Part 270 sets forth general rules applicable to the entire subchapter. Maximum lawful prices under NGPA sections 102 through 109 are implemented in Part 271. Part 273 provides for interim collections and refunds, while determinations of eligibility by state and federal agencies and Commission review of those determinations are provided for under Parts 274 and 275. Finally, Part 276 covers reports.

New Subchapter I will cover regulations under the NGPA other than those relating to producer regulation. The interim regulation prescribed today includes only Part 284, which implements the Commission's authority under sections 311(a) (relating to certain pipeline transportation of natural gas) and 312 (relating to assignment of intrastate pipeline's contractual right to receive surplus natural gas). Regulations relating to other authorities of the Commission will be added later under Subchapter I. [E.R. 1607]

* * *

Section 270.205 incorporates discussion at page 83 of the Statement of Managers which relates to the effect of establishment of ceiling prices under the NGPA on indefinite price escalator clauses in existing contracts. As discussed there, the mere establishment of NGPA ceiling prices will not trigger these clauses. The special rule is consistent with that discussion which is equally applicable to existing intrastate and interstate contracts. The phrase "indefinite price escalator clause" is defined for purposes of this special rule by reference to the definition in Section 105(b)(3)(B). Good cause exists to incorporate this special rule in the interim regulations given the uncertainty that would result absent a provision which provides guidance to the parties to those contracts. [E.R. 1619]

* * *

§ 270.205 **Indefinite price escalator clauses.**

(a) The establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate or interstate contracts. [E.R. 1793]

(b) For purposes of this section, the term "indefinite price escalator clause" shall have the same meaning as provided in section 105(b)(3)(B) of the NGPA.

FERC POLICY RESPECTING AREA RATE CLAUSES AND INDEFINITE PRICE ESCALATOR CLAUSES [AR. 1]

The Federal Energy Regulatory Commission (Commissioners Smith and Sheldon dissenting) on January 24, 1979, announced the following decision with respect to the effect of the Natural Gas Policy Act of 1978 (NGPA) on area rate clauses and indefinite price escalator clauses contained in interstate and intrastate contracts for sale of natural gas:

I. Escalator Clauses in Interstate Contracts

A. The Area Rate Clause

Section 154.93 of the Commission's regulations permit interstate natural gas contracts to contain provisions, known as "area rate clauses", which "permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved". The Commission does not believe it to be a correct interpretation of such clause, or the Commission's regulation which makes such clauses permissible, to conclude that the parties by agreeing to such clauses have thereby bound themselves to [AR. 2] pay the *maximum* lawful prices under NGPA to the preclusion of their ability to negotiate some lesser price within the NGPA *ceiling* prices. Nor would a clause have that effect if it merely referred to a "successor governmental authority". The Congress, under the plain meaning of such phrase, is clearly not a successor to the Commission. It it this Commission's master but not its agent or successor in interest.

The parties to any such contract are free to amend their contract (by specific amendment or letter agreement) to provide the requisite contractual authority to pay the NGPA rates, but the Commission will not interpret the area rate clause as requiring purchasers to pay such rates absent such amendment or letter agreement. (See Part III below).

B. Variant Clauses

The Commission has accepted for filing contracts containing a wide variety of escalator clauses, some of which have the same substantive effect as the clause prescribed in § 154.93, and some of which are much broader in scope.

If a clause included in a contract accepted for filing permits collection of NGPA rates, it will be given only the effect of the permissible clause prescribed in 18 CFR § 154.93(b-1), unless the producer can show that the Commission has either specifically approved the variant clause or has specifically waived the provisions of § 154.93 which would make the broader application of the clause inoperative.

[A. 3]

II. Intrastate Contracts

A. Where § 105(b)(1) applies

If § 105(b)(1) of the NGPA is the applicable maximum lawful price, then escalator clauses may increase the contract price in accordance with the contract terms (as in effect on November 9, 1979) but not to a level in excess of the new natural gas price under section 102 of the NGPA. The Commission will leave the interpretation of these clauses initially to the parties; however, a seller violates the

NGPA, and subjects himself to subsequent enforcement action, if an interpretation of an escalator clause is inconsistent with the terms of the clause.

B. Where § 105(b)(1) is inapplicable

If § 105(b)(1) does not apply to an existing intrastate contract or if a higher maximum lawful price is applicable under another provision of the NGPA, then interpretation of any escalator clause in the contract is left to the parties and to state law. However, the applicable maximum lawful price may not be exceeded.

III. Contract Modification

A. Interstate Contracts

In the case of contracts for sale of committed or dedicated gas, neither the NGPA nor the *Mobile-Sierra* doctrine preclude bilateral contract modification to permit collection of NGPA ceiling prices or interim or retroactive collections of these prices. Bilateral contractual modification may be evidenced by a contract amendment or letter agreement.

Passthrough of increased purchased gas costs which result from a modification, in an arms length transaction, of a contract in order to permit collection of an NGPA rate will not be precluded under section 601(c)(2) of the NGPA on grounds of fraud or abuse or on similar grounds merely because the pipeline purchaser is unable to show economic benefit to its ratepayers.

A contract modification may be retroactive to December 1, 1978, can be the basis for collection of a rate under the Commission's blanket affidavit procedure under

18 CFR 154.94(h), and may authorize collection of interim and retroactive collections under part 273 of the Commission's interim regulations. The period for filing protests to blanket affidavit filings under 18 CFR § 154.94(h)(7) will be extended to March 31, 1979.

B. Intrastate Contracts

In the case of gas which is not committed or dedicated, the parties may effect bilateral modifications of existing contracts, so long as the new contract price does not exceed the applicable maximum lawful price. Of course, where § 105(b)(1) is the applicable maximum lawful price and no higher price is applicable under another section, the ceiling price cannot exceed the price under the terms of the contract, and no price increase can be effected through contract modification.

* * *

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[18 CFR Parts 154, 270 and 273]

Before Commissioners: Charles B. Curtis, Chairman; Don S. Smith, Georgiana Sheldon, Matthew Holden, Jr., and George R. Hall. [R. 1052]

Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act	))))))	Docket No. RM79-22

ORDER NO. 23

ORDER ADOPTING FINAL REGULATIONS AMENDING AND CLARIFYING REGULATIONS UNDER THE NATURAL GAS POLICY ACT AND THE NATURAL GAS ACT

(March 13, 1979)

I. INTRODUCTION

The Natural Gas Policy Act of 1978[1] mandates a new legislative framework for the regulation of the natural gas industry. Its principal effect is to establish a comprehensive scheme of statutorily prescribed maximum ceiling

[1]P.L. 95-621, 92 Stat. 3350.

prices applicable to discrete types of "first sales" of natural gas occurring in both interstate and intrastate commerce. As such, the Natural Gas Policy Act in many respects limits, replaces or supersedes the application of the [R. 1053] previously controlling Federal statute, the Natural Gas Act,[2] and this Commission's authority and responsibility thereunder. Nevertheless, the Natural Gas Act continues to be of significance with respect to natural gas which was committed or dedicated to interstate commerce prior to enactment of the new legislative scheme.

Both the terms of the new statute and its legislative history demonstrate that the prices prescribed in Title I of the Natural Gas Policy Act are *ceiling* prices. Contractual provisions governing the purchase and sale of natural gas are superseded or nullified only to the extent that the contractual terms would provide for prices *in excess* of the statutory ceilings. Contractual terms which provide for prices below the statutory ceilings are unaffected.[3] In this regard, the Joint Explanatory Statement of the Committee on Conference (Conference Report) explains:

> [a]ll maximum lawful prices are ceiling prices only. In no case may a seller receive more than his contract permits.[4]

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[2]15 U.S.C. § 717 *et seq.* (1938).

[3]Section 101(b)(9) of the Natural Gas Policy Act provides:

> [in] the case of any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this title . . . , such maximum lawful price . . . shall not supersede or nullify the effectiveness of the price established under such contract.

[4]H.R. Report No. 95-1752, 95th Cong., 2d Sess., at p. 74. See also, the statement of Congressman John D. Dingell at 95 Cong. Rec. 1[illegible]17 (daily ed. October 14, 1978).

Generally speaking, the legislative scheme of the [R. 1054] Natural Gas Policy Act presents little difficulty in the case of *new* sales contracts where the parties are free to agree to any price so long as it does not exceed the applicable statutory ceilings. Also, in the case of *existing* sales contracts which specify a fixed price or provide for a schedule of specific price increases, the respective rights and obligations of the parties to the contract are readily discernible and the relationship of the Natural Gas Policy Act to that contract are relatively straightforward.

The vast majority of existing sales contracts, however, are not of that character. Most contain escalator clauses of one kind or another which permit upward price adjustments during the term of the contract. These upward price adjustments do not provide for fixed or definite price increments and frequently are not tied to a specific schedule but are "triggered" by other means. The relationship of the Natural Gas Policy Act to these contracts is less straightforward.

Consequently, considerable uncertainty now exists with respect to the rights and obligations of the parties to existing sales contracts which contain escalator clauses. Moreover, a number of questions have arisen concerning the operation of certain escalator clauses within the framework of the Natural Gas Policy Act and, to the extent it remains applicable, the Natural Gas Act. The questions involve matters of considerable economic significance. Also the issues involved are directly related and are of consequence to the Commission's administrative and enforcement responsibilities under both the Natural Gas Policy Act and the Natural Gas Act. The Commission shall speak to these fundamental issues in this order.

II. PROCEDURAL HISTORY [R. 1055]

The Commission's Interim Regulations Implementing the Natural Gas Policy Act at present contain the following admonition with respect to the operation of indefinite price escalator clauses:

> **§ 270.205 Indefinite price escalator clauses.**
>
> (a) The establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate or interstate contracts.
>
> (b) For purposes of this section, the term 'indefinite price escalator clause' shall have the same meaning as provided in section 105(b)(3)(B) of the NGPA.[5]

As noted in the Preamble to the Interim Regulations, § 270.205 was an attempt to incorporate the expression of Congressional intent at page 83 of the Joint Explanatory Statement of the Committee of Conference respecting the effect of the establishment of maximum lawful prices on indefinite price escalator clauses in existing intrastate con-

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[5]Section 105(b)(3)(B) defines indefinite price escalator clause as follows:

(B) Definition of Indefinite Price Escalator Clause. — — For purpose of this paragraph, the term 'indefinite price escalator clause' includes any provision of any contract — —

(i) which provides for the establishment or adjustment of the price for natural gas delivered under such contract by reference to other prices for natural gas, for crude oil, or for refined petroleum products; or

(ii) which allows for the establishment or adjustment of the price of natural gas delivered under such contract by negotiation between the parties.

tracts. The Commission's Interim Regulations applied the same rule to interstate contracts.[6]

Since the adoption of the Interim Regulations, we have [R. 1056] received numerous comments and requests for clarification. The Commission first considered this matter at an open meeting on December 21, 1978. Memoranda discussing the issue were inserted into the public record in Docket No. RM79-3 in order to solicit an expression of views and comments and to assist the Commission in resolving the issues presented by the rule. These memoranda also sought to address several questions which had arisen at various NGPA implementation seminars, through the Commission's telephone hot-line program, and at public hearings held before staff panels in Washington, D.C., New Orleans, San Franciso and New York. In response to these [R. 1057] comments, an oral argument was convened on the issues this order addresses before the Commission *en banc* on January 19, 1979. Nineteen parties participated in this argument, and numerous written comments were received.[7]

Following the oral argument, and after consideration of the comments, the Commission reached a tentative decision on the matters at issue in an open meeting on January 24, 1979.

The Commission had intended to issue an immediately effective final rule. The Commission was fully aware that continued uncertainty with respect to the contractual

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[6]See discussion at pages 19, *et seq.*, *infra.*

[7]*See,* Notice of Seminars Concerning Implementation of the Natural Gas Policy Act of 1978, November 14, 1978; *see also,* Order Setting Oral Argument, issued January 12, 1979, in Docket No. RM79-3. FERC News Release FE-474, November 13, 1978. FERC News Release FE-468, November 1, 1978.

rights of the parties could (and would if allowed to go on much longer) have serious detrimental effects in the marketplace. It was our objective, therefore, to address this matter in a comprehensive way as early as practicable. However, upon concluding the review of the proposed order, the Commission recognized that there were still some lingering questions concerning the foundation and rationale advanced for the tentative conclusions. Also, in light of the complexities and importance of the issues involved, the Commission determined that it would be a more prudent course to test its preliminary conclusions in a further comment period and to seek to measure the consequences of the proposed decision. [R. 1058]

For these reasons, on February 13, 1979, the Commission published its tentative conclusions in the form of a proposed rulemaking, vacating its previous determination to issue an immediately effective final rule. In its notice, the Commission not only asked for views on its proposed rule, but also invited comments on three alternative approaches.

On February 27, 1979, a public hearing was convened at which 20 parties appeared. In addition, we received written comments from numerous parties, including Members of Congress, government agencies and officials, producers, pipelines, distribution companies, other purchasers and consumer groups.

The Commission has evaluated each of the oral and written comments presented.[8] On the basis of that evalua-

[8]As we stated in our notice at page 5, the rule was proposed in a separate docket number. We reiterate that the action we take today, although issued in Docket No. RM79-22, reflects consideration of all relevant comments submitted in Docket Nos. RM79-3 and RM79-4. We further reiterate that we take official notice of and incorporate by reference the relevant portions of those dockets.

tion the Commission has determined to revise its preliminary views on these matters in a number of important respects. In the following section containing the Commission's Analysis and Decision we have dealt specifically with a number of the comments and have appended to this order a summary of the major arguments presented to us. It is entirely impracticable in the circumstances to discuss each and every argument submitted for our consideration. Accordingly, the Commission advises that, although we have considered the entirety of the comments submitted to us, some raise questions beyond the scope of this order and consequently are not dealt with herein.[9] [R. 1059]

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[9]Tenneco Oil Company and others (Tenneco) have filed a motion requesting the Commission to waive the requirement that persons apply for rehearing of this order prior to seeking judicial review thereof. The need for rehearing of rules and regulations issued under the Natural Gas Policy Act arises under section 506 of that Act and Commission Order No. 21 (January 3, 1979). Section 506(b) does not expressly require rehearing of rules and regulations promulgated under the Natural Gas Policy Act. The Conference Report, however, "provides [that] judicial review [under the NGPA shall be] based on the Natural Gas Act * * *." H.R. Rep. No. 95-1752 at 122, 95th Cong., 2d Sess. (1978). In issuing Order No. 21, the Commission "determined to give effect to the expressed intention of [Congress] that generally the judicial review procedures under the NGPA should follow those under the Natural Gas Act" (Order No. 21 at 6), and adopted regulations providing for rehearing of rules and regulations issued pursuant to the Natural Gas Policy Act. Petitions for review of Order No. 21 are pending before the Fifth Circuit Court of Appeals in *Ecee, Inc., et al. v. FERC*, No. 79-1171.

Tenneco suggests that the rehearing requirement should be waived in this proceeding because there is no substantial need for further Commission action in this proceeding and because rehearing in this docket will adversely impact arrangements in the *Ecee* case to resolve expeditiously the question of the validity of Order No. 21. Tenneco presents various arguments in support of its position that rehearing should be waived in this proceeding. In essence, Tenneco argues that all interested persons have had several opportunities to present their

III. COMMISSION ANALYSIS AND DECISION

[R. 1060]

Before proceeding with our analysis, we believe it advisable to make a few preliminary points. First, the Commission fully accepts the view that the maximum lawful ceiling prices prescribed under the Natural Gas Policy Act are "just and reasonable" prices for purposes of section 4 and section 5 of the Natural Gas Act. The Congress has [R. 1061]

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views and that further delay would not be beneficial. While we sympathize with Tenneco's desire to obtain prompt judicial review of the Commission's order in this proceeding and agree that this proceeding must be brought to a conclusion as expeditiously as is practicable in the circumstances, we must deny the request for waiver of the rehearing requirement.

In this proceeding, the Commission is acting pursuant to both the Natural Gas Policy Act and the Natural Gas Act, and is amending regulations adopted pursuant to the Natural Gas Act. Section19(a) of the Natural Gas Act, 15 U.S.C. 717r(a) provides to all adversely affected persons a right to petition the Commission for rehearing of orders within 30 days after issuance. Thereafter, if rehearing is denied by the Commission, that person may seek judicial review as provided by section 19(b), 15 U.S.C. § 717r(b). *See, e.g., Federal Power Commission v. Colorado Interstate Gas Co.*, 348 U.S. 492, 497-499 (1955). The Commission lacks the authority, to waive at the behest of any individual party the statutory right conferred on all interested persons to seek rehearing, just as no person may seek judicial review until he has exhausted that remedy. *E.g., Federal Power Commission* v. *Colorado Interstate Gas Co., supra; Boston Gas Co.* v. *Federal Energy Regulatory Commission,* 575 F.2d 975, 977-979 (1st Cir. 1978). We also conclude that the same rule should apply under the Natural Gas Policy Act, both because Congress intended that judicial review under the Natural Gas Policy Act would generally follow the pattern of judicial review under the Natural Gas Act, and because exhaustion of rehearing remedies is a useful and practical administrative prerequisite to development of the Commission's final decisions. Furthermore, even if the Commission had the authority to waive the rehearing requirement under the Natural Gas Policy Act, we find no good cause for doing so in this proceeding. This order constitutes the Commission's initial promulgation of final regulations specifically addressing the operation of various indefinite pricing clauses. Rehearing will af-

clearly said so in section 601 of the Natural Gas Policy Act. Moreover, the Commission does not (nor could it properly) object to such prices on the basis that they are "too high" or that they are not adequately "cost-related or justified". The Congress has struck the balance between consumer and producer interest; reserved to this Commission is only the task of administration and the authority to prescribe *higher* price ceilings in certain circumstances.[10] [R. 1062]

Second, our purpose and responsibility here is to give effect to Congressional intent as that may be gleaned from the contemporaneous legislative history which was constructed at the time the Natural Gas Policy Act was enacted.

Third, we cannot responsibly withdraw from the field and refuse to examine contractual arrangements as has been suggested to us. Both the Natural Gas Policy Act and the Natural Gas Act relate the terms of contractual arrangements between buyers and sellers to the controlling statutory requirement. On this last point, some further amplification may be helpful.

The Congress has resided in this Commission both the authority and responsibility to administer the Natural Gas Policy Act and, in particular, to insure the integrity of the ceiling prices established in Title I. In several instances statutory requiremens are based on contractual relationships. In particular, with respect to natural gas not previously committed or dedicated to interstate commerce

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ford the Commission the opportunity to correct any errors prior to judicial review and to narrow and refine any issues which might be presented to the courts. Finally, rehearing will not unduly delay final resolution of the issues herein. For these reasons, Tenneco's motion is denied.

[10] *See*, sections 104(b)(2), 106(c), 107(b) and 109(b)(2).

which is being sold under an existing contract, the statutory ceiling price is the price under the terms of the contract as it existed on November 9, 1978 (section 105(b)(1)). Also, the maximum lawful price which governs any rollover contract of natural gas which was not previously committed or dedicated to interstate commerce is governed by reference to the terms of the expired contract. Accordingly, under the legislative scheme, this Commission must necessarily become involved in reviewing the contractual arrangements between parties to existing contracts as they relate to natural gas not previously committed or dedicated to interstate commerce.

In the case of gas previously committed or dedicated to interstate commerce which is being sold under existing contracts, the Commission's responsibility is even more direct and substantial.[11] As previously noted in introduction, the Natural Gas Act and the Commission's regulations continue to apply in many important respects to natural gas which was previously committed or dedicated [R. 1063] to interstate commerce. It is true that they system of legislatively prescribed maximum ceiling prices replaces in large measure both the Commission's authority and its responsibility to establish just and reasonable rates ap-

[11]The "more direct and substantial responsibility" to which the above paragraph refers attaches only to natural gas which *was* previously committed or dedicated to interstate commerce and which is being sold under an existing contract. The Commission takes this opportunity to emphasize the importance of the distinction between natural gas which was not committed or dedicated to interstate commerce on the day before date of enactment, and that which was. It is not a question of interstate or intrastate commerce, as such. In other words, natural gas which was not previously committed or dedicated to interstate commerce would not be subject to additional restrictions merely because the rollover contract was executed with an interstate pipeline or an interstate pipeline succeeded to the purchaser's interest in an existing contract. In either instance, sections 105 and 106(b) of the Natural Gas Policy Act would govern.

plicable to producer sales in interstate commerce. And it is equally true that the Congress has deemed the statutory ceiling prices to be just and reasonable for purposes of sections 4 and 5 of the Natural Gas Act. But the question still remains whether there exists the requisite contractual authority to charge and collect such prices. The principal established in section 101(b)(9) of the Natural Gas Policy Act is that the legislation prescribes ceiling prices. The Congress specifically recognized that contract prices may be lower than the Federal maximum lawful price and that, [R. 1063] in such circumstances, the contractual arrangements between the parties would continue to govern their relationship, and not be superseded by the Federal ceiling price.[12] Thus, where the Natural Gas Act continues to govern, the Congress seems to have intentionally preserved the *Mobile-Sierra* line of cases[13] which require this Commission to determine not only whether the rate is just and reasonable but also whether the sales contracts between the parties authorize those rates.

In the *Mobile-Sierra* cases, the Supreme Court held that a utility may not unilaterally file for increased rates when the company's contracts with its wholesale customers fix the rates for the contract term. This simply means that the contract between the parties governs the legality of the filing. Rate filings consistent with contractual agreements are valid; rate filings inconsistent with contractual obliga- [R. 1065 tions are invalid.[14] This rule of law parallels the preserva-

[12]Remarks of Congressman John D. Dingell, 95 Cong. Rec. 13117 (daily ed October 14, 1978).

[13]*United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1950); *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1950); *United Gas Pipe Line Co.* v. *Memphis Light, Gas and Water Division, et al.*, 358 U.S. 103 (1958).

[14]*Richmond Power & Light* v. *FPC*, 481 F.2d 490 (1973). *See Otter Tail Power* v. *FPC*, 536 F.2d 240 (1976); *Appalachian Power Co.* v. *FPC*, 529 F.2d 342 (1976).

tion of a buyer's contractual right to purchase natural gas at prices below the Natural Gas Policy Act ceiling prices as contained in section 101(b)(9). Accordingly, the *Mobile-Serria* doctrine requires the Commission to determine whether contractual authorization exists for the collection [R. 1066] of the maximum lawful prices established by the Natural Gas Policy Act.

Because the statutory requirement and this Commission's responsibilities differ with respect to gas sold under existing contracts depending on whether the gas was previously committed or dedicated to interstate commerce, we will address these matters separately. For convenience, we will refer to "existing intrastate contracts" and "existing interstate contracts". Readers of the Commission's order should keep in mind that these terms do not accurately track the distinction wwith which the Congress has drawn in the Natural Gas Policy Act.[15]

A. Background

Existing intrastate contracts contain a variety of indefinite escalator and price redetermination provisions. One common form is a favored nations clause, requiring the price paid to increase to keep pace with other prices paid for natural gas in some defined area. Another is a price-reference clause which provides for an increase in price tied to any increase in the delivered price of some other fuel. Redetermination provisions generally provide that as of a particular time during the contract term or upon the happening of a stated event, the parties will negotiate a new price. Still another common type of clause

[15]As noted previously in footnote 12, the distinction turns on whether the gas under the existing contract was previously committed or dedicated to interstate commerce on November 8, 1978.

is the use in an intrastate contract of an "FPC clause", which would operate to increase the contract price whenever the FPC or FERC set a new just and reasonable rate.

Each of the aforementioned escalator and price redetermination provisions would appear to be "indefinite price escalator clauses" falling within the definition contained in section 105(b)(3)(B) of the Natural Gas Policy Act. Section 105(b)(3) applies to the post-1984 period and it may be suggested that the definition contained in clause (B) has no current applicability. However, the Conference Report discussion, appearing at page 83, indicates that the Conferees specifically considered the question of the pre-1985 [R. 1067] applicability of indefinite price escalator clauses and had some specific views and instructions to offer with respect to their effect and applicability. It may be safely presumed, we think, that the Conferees intended to attach the same meaning to the term "indefinite price escalator clause" in its discussion as it attaches to the use of that term in the section of the Act to which that discussion, in large measure, pertains. On pages 82-83 of the Conference Report we are told several important things in this regard.

First, in the case of sales of natural gas under an existing intrastate contract, the statutory ceiling price depends upon the contract price in effect on the date of enactment of this Act (November 9, 1978). If the contract price in effect on November 9, 1978, is less than the new gas ceiling price (i.e., the section 102 price applicable to "new gas"), the maximum lawful price, beginning in December 1978 and any subsequent month, is the lower of (1) the price under the terms of the existing contract in effect on November 9, 1978, or (2) the new gas price. This is the formula provided in section 105(b)(1). Thus, we are told, "the price under the contract may escalate through the operation of both fixed price escalator clauses and indefinite

price escalator clauses in existence as of the date of enactment, but the price may not exceed the new gas price."[16]

On the other hand, if the contract price in effect on [R. 1068] November 9, 1978, is greater than the new gas price, the maximum lawful price formula under section 105(b)(2) would allow further in cases in the contract price only to allow for adjustments for inflation, unless or until the new gas price catches up to the adjusted contract price. Thereafter the price may increase to track the increase in the new natural gas price. Accordingly, the operation of both fixed price escalator clauses and indefinite price escalator clauses is limited to the rate of the inflation adjustment unless and until the new gas price catches up and thereafter exceeds the inflation adjusted contract price.

Having thus set out the basic method for determining the maximum lawful price applicable to existing intrastate contracts, the conferees then turn to a discussion of the operation of indefinite price escalator clauses. This discussion notes that the provisions of section 313 of the Natural Gas Policy Act specifically prohibit prices paid in any sale of high-cost natural gas, from triggering the operation of any indefinite price escalator clauses. The conferees also observe that the Federal government has ceded to states under section 602 the authority to further limit the operation of price escalator clauses as an adjunct to their authority to prescribe lower maximum lawful prices for the first sale of natural gas produced within the state.

Then the following paragraph appears: [R. 1069]

> Some intrastate contracts currently in existence contain indefinite price escalator clauses which can be triggered by a number of factors, including adjustments by the Commission of

[16]H.R. Report No. 95-1752, 95th Cong., 2d Sess., at p. 82.

> "just and reasonable" rates established under the Natural Gas Act. The conferees do not intend that the mere establishment of the ceiling prices under this Act shall trigger indefinite price escalator clauses in existing intrastate contracts. Once natural gas is sold pursuant to the ceiling prices under this Act, such clauses would be activated as limited by this Section.

In the immediately preceding paragraph of the Conference Report, we are told that "[t]his section of the Conference Agreement is not intended to apply to interstate contracts in existence as of the date of enactment"[17], and that the Conferees were aware that "[s]uch contracts are currently subject to regulation by the Commission pursuant to the Natural Gas Act." The Conferees then go on to assert that "[C]ommission regulations bar the use of indefinite price escalator clauses in interstate sales."

These two paragraphs which appear at page 83 of the Conference Report, lie at the root of the debate and confusion which attends the question of the operation of indefinite price escalator clauses under the Natural Gas Policy Act. And it is this Commission's attempt to give expression to the Congressional intent embodied in these [R. 1070] paragraphs that has focused comment on the important questions which relate to the operation of price escalator clauses under the Act.

In crafting its Interim Regulations implementing the Natural Gas Policy Act, the Commission merely attempted to incorporate in its Regulations an approximation of the legislative expression contained on page 83 of the Conference Report. Inasmuch as the Regulations were re-

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[17]Presumably the reference to "this section" is a reference to section 105 of the Natural Gas Policy Act.

quired to be effective on December 1, 1978, only three weeks from date of enactment, time did not permit a considered exposition of the effect of indefinite price escalator clauses under the Act. Thus, the Commission provided in § 270.205 (18 C.F.R., § 270.205) that:

> (a) The establishment of maximum lawful prices under the NGPA shall not trigger indefinite price escalator clauses in existing intrastate or interstate contracts.
>
> (b) For purposes of this section, the term "indefinite price escalator clause" shall have the same meaning as provided in section 105(b)(3)(B) of the NGPA.

With respect to existing intrastate contracts, § 270.205 approximates the language contained in the second sentence of the last paragraph on page 83 of the Conference Report. The section was made equally applica- [R. 1071] ble to interstate contracts in order to make clear that the current bar to certain indefinite price escalator clauses under existing Commission Regulations would continue in effect. In so doing, we were attempting to give expression to the intent and requirement of the penultimate paragraph contained on page 83 of the Conference Report.[18]

Existing interstate contracts like their counterparts in the intrastate market, contain a variety of price escalator clauses. But unlike the situation that obtains with respect

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[18]In this regard Senator Henry M. Jackson, Senate Floor Manager for consideration of the Natural Gas Policy Act, stated, in referring to indefinite pricing provisions, "However, operation of those clauses is prohibited by current Commission Regulations. There is no intent to change or otherwise modify that prohibition." 95 Cong. Rec. S. 15021 (daily ed. Sept. 13, 1978)

to intrastate contracts, certain price escalator clauses contained in interstate contracts have been prohibited or made inoperative under Commission Regulations promulgated pursuant to the authorities contained in the Natural Gas Act. [R. 1072]

The current prohibitions are contained in § 154.93 of the Commission's Regulations under the Natural Gas Act. Generally speaking, this Regulation makes inoperative any provision in an interstate contract whch provides for a change in price which is not in the form specifically permitted by the Regulations. Specifically, § 154.93 provides in pertinent part:

> *Provided,* that in contracts executed on or after April 3, 1961, for the sale or transportation of natural gas subject to the jurisdiction of the Commission, any provision for a change of price other than the following provisions shall be inoperative and of no effect at law; the permissible provisions for a change in price are:
>
> (a) Provisions that change a price in order to reimburse the seller for all or any part of the changes in production, severance, or gathering taxes levied upon the seller;
>
> (b) Provisions that change a price to a specific amount at a definite date:
>
> (b-1) Provisions that permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved; and
>
> (c) Provisions that, once in five-year contract periods during which there is no provision for a

change in price to a specific amount (paragraph (b) of this section), change a price at a definite date by a price-redetermination based upon and not higher than a producer rate or producer rates which are subject to the jurisdiction of the Commission, are not in issue in suspension or certificate proceedings, and, are in the area of the price in question: *Provided further,* That any contract executed on or after April 2, 1962, containing price-changing provisions other than the permissible provsiions set forth in the proviso next above shall be rejected. [Order 242, 27 F.R. 1357, Feb. 14, 19672, as amended by Order 329, 31 F.R. 15486, Dec. 8, 1966]".

Thus, current Regulations of the Commission declare [R. 1073] "inoperative and of no effect at law" most indefinite price escalator clauses. And it was of this prohibition that Senator Jackson spoke when he stated that there was no "intent to change or otherwise modify that prohibition".[19] The problem occurs with respect to paragraph (b-1) of the above quoted proviso. There the Regulation specifically allows to operate a provision which would "permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved". Contractual clauses of the character permitted under paragraph (b-1) of § 154.93 have come to be known as "area rate clauses" or "FPC clauses".

First, it should be noted that an "area rate clause" would fall within the technical definition of indefinite price escalator clauses contained in section 105(b)(3)(B) of the Natural Gas Policy Act. Further evidence that the Con-

[19] 95 Cong. Rec. S. 15021 (daily ed. Sep. 13 1978).

gress regarded area rate clauses as indefinite price escalator clauses can be gleaned from the first sentence in the last paragraph appearing on page 83 of the Conference Report which states, "[s]ome intrastate contracts currently [R. 1074] in existence contain indefinite price escalator clauses which can be triggered by a number of factors, *including* adjustments by the Commission of just and reasonable rates established under the Natural Gas Act". It is possible to structure an argument that the Congress misperceived the effect of the Commission's Regulations believing that those Regulations constrained the operation of area rate clauses in interstate contracts, thus making it unnecessary for the Congress to address the question in specific terms. We do not think, however, there is much substance to such an argument. The more likely construction of legislative intent is that the Congress intended that the Commission continue to prohibit that which was prohibited, but allow to operate that which has been permitted under the terms of the Commission's Regulations.

It is from this perspective, that the Commission examined in its proposed rulemaking the provisions of § 154.93 of its Regulations under the Natural Gas Act. After reviewing the historical development of the prohibitions contained in § 154.93 and the development of area rate clauses. the Commission reached the tentative conclusion that any contractual clause which tracked the literal text of paragraph (b-1) of § 154.93 would not be triggered by the [R. 1075] Natural Gas Policy Act. And, any price escalator clause which did not follow the literal text of paragraph (b-1) of § 154.93, was by the specific terms of that Regulation made "inoperative and of no effect at law". Accordingly, the Commission reasoned that any such clause would be given no greater effect than a clause specifically permitted under paragraph (b-1). With respect to whether a conforming area rate clause was triggered, the Commission noted

that the Regulation permitted price increases only to the "applicable just and reasonable area rate . . . *prescribed by the Commission.*" The Natural Gas Policy Act ceiling prices are not prescribed by the Commission; they are prescribed by Congress. Accordingly, adopting what it characterized as a "plain meaning" construction, the Commission stated that area rate clauses conforming to the literal text of the Commission's Regulations would not trigger to the Natural Gas Policy Act rates and those which did not conform to the literal text were rendered inoperative under the Regulation.

Similarly, it was the Commission's preliminary view that intrastate contracts which contained an "FPC-type clause" conforming to the literal text of the Commission's Regulations would also not trigger the Natural Gas Policy Act rates. Moreover, the Commission expressed the opinion that area rate clauses, whether in interstate or interstate contracts, which permitted escalation in the event of action to be taken by a "successor governmental authority" [R. 1076] should not be read as triggered by the Natural Gas Policy Act rates. Here the Commission reasoned that Congress was not a "successor" to the Commission but rather is the Commission's predecessor and progenitor from which its authority derives.[20]

The Commission is now convinced that the initial view taken in the proposed rulemaking was incorrect in a number of respects and must be revised.

The principal flaw in the Commission's reasoning lies in the too narrow focus of the proposed rule on the provi-

[20]The Commission also reached the tentative conclusion that parties to interstate contracts were generally free to amend their contracts to allow for the payment of the statutory ceiling. The proposed order also addressed the question of amendment authority with respect to interstate contracts.

sions of §154.93 (b-1) and the weight given to the literal text of that provision. Several persons commenting in this proceeding pointed out the weakness in this approach with convincing argument.[21]

As the Commission noted in its proposed rulemaking, [R. 1077]
the current prohibitions embodied in § 154.93 find their antecedents in Federal Power Commission Order No. 232 which was issued in 1961. That order prospectively banned the effectiveness of certain types of indefinite pricing clauses in interstate contracts. The FPC was primarily concerned with favored nation, redetermination, or spiral escalation clauses which it characterized as "undesirable, unnecessary and incompatible with the public interest." In essence the Commission determined that such indefinite escalator provisions were "contrary to the public interest" and must be prohibited.[22] It is also worth noting that the FPC had initially proposed an outright bar on all indefinite pricing provisions, only permitting producers and pipelines to include definite pricing provisions in contracts.

On rehearing, the FPC amended its proposed ban to allow certain:

"Limited price-redetermination provisions, invokable not more than once in every five-year contract period and based upon rates subject to this Commission's jurisdiction (*and, therefore, controlled*)."[23] These limited price-redetermination provisions were allowed in order to permit pricing flexibility and to provide an incentive for long-

[21] *See*, comments of the Public Service Commission of the State of New York filed February 26, 1979, in Docket No. RM79-22 and comments of Indicated Producers filed February 26, 1979, in Docket No. RM79-22.

[22] Order No. 232-A, 25 FPC 609 (1961).

[23] FPC Order No. 232-A, (Emphasis supplied).

term contracts. Several conclusions of importance to the instant proceeding can be drawn from this brief recounting of the development of § 154.93 of the Commission's [R. 1078] Regulations. First, the rule firmly stands on a determination that prohibited indefinite escalation provisions are "contrary to the public interest". The continued viability and application of this rule, therefore, would seem to turn on whether the Commission could successfully establish that it had a reasonable basis for concluding that a particular prohibited clause was contrary to the public interest.

It is now the Commission's view that we would lack authority to apply § 154.93 to make inoperative and of no effect at law a price escalation provision as would have specifically bound the parties to the outcome of legislative or specific Congressional action. Thus, if a contract provided for escalation to rates established by the Congress, or by legislative action, or specificially referenced the Natural Gas Policy Act prices, this Commission would be without authority to apply § 154.93 to preclude the operation of such clauses on a "contrary to the public interest" standard. We would agree that if the Commission found it appropriate to allow parties to bind themselves to the outcome of Commission proceedings in the exercise of Congressionally derived authority, we could not rationally maintain that it was contrary to the public interest for the parties to contractually bind themselves to actions taken by the Congress directly.

Moreover, we do not believe that we could apply [R. 1079] § 154.93 on a "contrary to the public interest" standard so as to preclude an interpretation of the contractual arrangement between the parties or an amendment to such contract which would bind the parties to the Natural Gas Policy Act maximum lawful ceiling prices. Thus, we have concluded that the Commission's original focus on the

provisions of § 154.93 was misplaced. And, to the extend that section of the Commission's Regulations under the Natural Gas Act remains applicable, it is our view that it neither bars nor makes ineffective specific contractual provisions which incorporate the Natural Gas Policy Act prices or provisions which provide for price escalation tied to the outcome of Congressional or legislative action.

Those indefinite price escalation clauses which § 154.93 specifically intended to prohibit, such as favored nation, redetermination, or spiral escalation clauses, would continue to be rendered inoperative under the Regulation. This result was clearly the intent of the Congress at the time the Natural Gas Policy Act was enacted.

The question still remains, however, whether "typical area rate clauses" operate to permit escalation of contract prices to the maximum ceiling prices provided in the Natural Gas Policy Act. The answer to this question the Commission believes, is necessarily linked to questions of [R. 1080] contractual interpretation and the intent of the parties to that contract. Before turning to that subject, it may be useful to first return to the legislative history of the Natural Gas Policy Act to search for Congressional guidance and instruction on this subject.

B. Congressional Intent Respecting the Operation of Area Rate Clauses

The question of Congressional intent as it relates to the operation of area rate clauses was extensively discussed in the written comments and in oral argument before the Commission. A perusal of the contemporaneous legislative history constructed at the time the Natural Gas Policy Act was considered, however, reveals little in the way of direct and specific guidance on this matter. As previously discussed, there appears only the discussion on pages 82 and 83 of the Conference Report and the state-

ment by Senator Jackson during the time of Senate floor consideration. In large measure therefore, the Commission is left to deduce the intent of Congress with regard to this matter.

Several members of the House and the Senate together with Secretary Schlesinger have filed comments with the Commission. Senator Domenici of New Mexico and Congressman Treen of Louisiana also appeared and offered their views in oral argument before the Commission.[24] [R. 1081] It is true, as the New York Public Service Commission[25] points out, that the Commission must look to the *contemporaneous* legislative history. In other words, we must look to see what Congress said at the time the Act was considered. On the other hand, while we cannot regard the views stated by the members of the Congress and Secretary Schlesinger as constituting official legislative history, it is entirely appropriate to evaluate those views as they may provide guidance to the Commission in its effort to deduce legislative intent. Similarly, the Commission has evaluated the views of the other parties in construing Congressional intent.

The arguments concerning legislative intent proceed on two basic lines. First are those which emphasize the basic objectives of the Natural Gas Policy Act as being grounded in the need to (1) remove distinctions between inter- and intrastate markets, (2) provide price predictability, and (3) establish incentives for increased production. This line of argument places heavy emphasis on Congressional [R. 1082]

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[24] *See*, Comments of Senator Pete Domenici filed January 18, 1979 in Docket No. RM 79-3; see also Statement of Senator Pete Domenici filed February 27, 1979 in Docket No. RM79-22, and oral argument February 27, 1979, Tr. 3-10; and Statement of Congressman David Treen at oral argument February 27, 1979, Tr. 21-24.

[25] Comments of the Public Service Commission of the State of New York, *supra*, at 3, 4.

recognition that the real dollar value for flowing gas should be preserved through the mechanism of statutory automatic inflation adjustments to the maximum ceiling prices. Considerable weight is also given to the Congress having deemed the maximum lawful ceiling prices to be "just and reasonable" for purposes of section 4 and 5 of the Natural Gas Act. Several commenters have also called the Commission's attention to the fact that the section 103 price ceiling (relating to new, onshore production wells) and the section 102 price (relating to new gas production) as well as the section 107(a)(1) price (relating to deep wells) all employ concepts which measure eligibility on the basis of drilling activity which occurred on or after February 19, 1977—activity which in the extreme would have occurred almost 19 months *prior* to date of enactment. It is argued that the use of the February 19, 1977 date evidences a specific Congressional intent to provide a statutory substitute for the so-called "missing biennium rate".[26] Lastly, this line of argument calls attention to the [R. 1083] various economic analyses which were prepared and are a part of the contemporaneous legislative history of the Natural Gas Policy Act. Each of these analyses makes assumptions with respect to producer revenues, and consumer impacts and supply response which are generally consistent with an expectation that the area rate clauses in

[26]In Opinion 770-A the Federal Power Commission had committed to a biennium rate process which would adjust the national rate every two years. The Commission had initiated a proceeding to establish a biennium rate for 1977 and 1978 gas vintages, but suspended that proceeding after both Houses of Congress passed legislation which would discard the Natural Gas Act cost-based pricing methodology. *See*, Comments of the State of Texas, filed February 27, 1979 and Statement of the Texas Independent Producers and Royalty Owners Association, filed February 27, 1979.

existing contracts would trigger to the statutory ceiling prices.[27]

The second line of argument emphasizes that the Natural Gas Policy Act establishes a series of *ceiling* prices. And that contracts which provide for lower prices are intended to be given contract sanctity and left undisturbed by the passage of the Natural Gas Policy Act. This line of argument places heavy weight on the Congressional intent to provide a transition to deregulation by 1985. Thus, Congress provided for scheduled increases in the maximum lawful ceiling prices with the full expectation that market forces would develop as supply and demand are gradually brought into balance—thus justifying the removaL of price controls at the end of the six-year period. Accordingly, this line of argument would suggest that it is basically inconsistent with the transitional mechanisms for deregulation to conclude that the vast majority of existing contracts which contain area rate clauses [R. 1084]

[27]The studies were prepared by the Department of Energy/Energy Information Administration, the staff of the House Subcommittee on Energy and Power and the Congressional Budget Office. The Commission believes it appropriate to comment very briefly on this point. Several factors reduce the persuasiveness of the argument. First, not one of the studies makes a specific assumption concerning the applicability of area rate clauses. It could equally well have been assumed that the relative supply/demand imbalance in the marketplace was sufficient to drive the current prices to the maximum statutory ceilings. Second, the studies do not appear to take into account that a considerable amount of gas continues to be sold at fixed price contracts. Third, as Secretary Schlesinger pointed out in his statement, the DOE/FIA study assumes that existing stripper well prices would not rise to the stripper ceiling "until current contracts expired". While no explanation of this assumption is given, it would seem inconsistent with the theory that all area rate clauses are triggered to the Natural Gas Policy Act ceilings and at the same time assume that in the case of existing stripper wells the price ceilings would not be obtained until current contracts expire.

all trigger to the maximum ceiling prices provided in the Natural Gas Policy Act, thereby locking the purchaser into the obligation to pay the maximum ceiling prices to the preclusion of his ability to bargain for a lesser price.

Also, although no party to this proceeding appears to have raised the point, it may be contended that the blanket triggering of area rate clauses to the Natural Gas Policy Act ceiling prices would seem to run counter to the Congressional objectives in Title II of the Natural Gas Policy Act concerning incremental pricing. At least one of those objectives is to pass a portion of the incremental cost of purchased natural gas directly on to price sensitive [R. 1085] industrial boiler fuel users to brig their cost in line with alternative fuel cost so as to hasten the time at which supply and demand comes into balance, and to create incentives for pipelines to negotiate prices to guard against loss of their industrial load. It would seem basically inconsistent to maintain that interstate pipelines are *both* forced to pass these incremental costs on to their most price sensitive marginal customers and at the same time, bound under their previously existing contractual arrangements to pay the maximum ceiling prices to the preclusion of their ability to negotiate lesser prices.

The Commission does not believe in the instant case that an entirely satisfactory resolution of the multiple objectives of the Natural Gas Policy Act can be found. As these objectives relate to the matter at hand they appear to be in basic conflict. If area rate clauses are triggered to the Natural Gas Policy Act ceiling prices, some Congressional objectives will be furthered while others would appear to be frustrated. On the other hand, if area rate clauses are not triggered, some Congressional objectives will be met while others would be frustrated. Also, our search for a middle ground has not borne much fruit. We are able, however, to draw some conclusions with respect to the in-

tended operation of the Commission's current prohibitions on indefinite price escalator clauses contained in § 154.93 of its Regulations under the Natural Gas Act. [R. 1086]

After evaluating the comments and views expressed, it would appear that, while the Congress cannot be said to have conclusively *intended* to have area rate clauses trigger to the Natural Gas Policy Act ceiling prices to the preclusion of the parties ability to negotiate lesser prices, the Commission cannot find a convincing basis upon which to conclude that the Congress *did not intend* to allow area rate clauses to trigger to the statutory ceiling prices.

In short, we find that the prohibitory language in § 154.93 of the Commission's Regulations to be too slender a reed upon which to place the weight of a Commission decision that area rate clauses were intended not to be triggered by the statutory ceiling prices. The Congressional direction contained on page 83 of the Conference Report is simply too ambiguous to rely on to reach a conclusion of this consequence.

It does appear that under paragraph (b-1) of § 154.93, the Federal Power Commission permitted, as consistent with the public interest, price escalator clauses to operate to bind the parties to the outcome of Commission proceedings which prescribed just and reasonable rates of general applicability. The FPC appeared to require as a matter of public policy only that the rates be controlled,[28] that they be just and reasonable, that they be generally applicable to an area, and that they apply to the quality of the gas involved (i.e., vintage). The Natural Gas Policy Act maximum ceiling prices fit each of these criteria. [R. 1082]

It is true that the rates are not prescribed by the Commission but by the Congress. While that distinction may

[28]See page 26, *supra*.

have some importance to the parties to a contract and parties in interest to interstate sales contracts[29], it cannot serve as a proper basis for the Commission concluding that its regulations under §154.93 preclude the parties from relying on area rate clauses as a basis for charging and collecting the Natural Gas Policy Act statutory prices. To our earlier discussion concerning the applicability of § 154.93 of our current Regulations, we add only the question: does it seem reasonable that the Congressional reliance on the prohibitions contained in existing Commission Regulations—which *permitted* and did not prohibit area rate clauses—could be construed as an intention to disallow the operation of area rate clauses? We think not.

Accordingly, the Commission has concluded that § 154.93 of its current Regulations does not *bar* or proscribe reliance on an appropriate area rate type clause [R. 1088] as authority for charging and collecting applicable Natural Gas Policy Act prices. It could be expected that Congress would have little patience with the assertion by this Commission, on a public interest standard, that § 154.93 bars the operation of area rate clauses to preclude the incorporation of rates which the Congress has determined are "just and reasonable" simply on the basis that such rates were prescribed by the Congress and not by this Commission. It is even harder to conclude that Congress *intended* that reading of §154.93.

The Commission's inquiry does not end with the above conclusion, however; nor does its responsibility. Although we have concluded that our existing Regulations do not preclude reliance on area rate clauses, the question still remains whether such clauses, in fact, operate to trigger to the Natural Gas Policy Act ceiling prices. As previously

[29]See following discussion on pages 39-41, *infra*.

noted, the answer to this question turns on matters of contract construction and the intent of the parties.

C. Operation of Area Rate Clauses - Contractual Construction and Interpretation

A great number of the comments filed directed their attention to the intent of parties who entered into area rate clauses. Of particular relevance was the substantial level of agreement between most sellers and buyers as to what was [R. 1089] generally intended when the area rate clause was executed. Equally important, however, was the representation that area rate clauses vary considerably in their wording, and that no definitive statement could therefore be made by the Commission that would resolve all concerns.

Most sellers of natural gas in the interstate market have taken the view that the intent of parties in agreeing to an area rate clause was to permit escalation to the highest ceiling price permitted by law.[30] Most interstate pipeline purchasers have endorsed this position. At oral argument on February 27, 1979, the Interstate Natural Gas Association of America (INGAA), a trade association of interstate pipelines, stated that it was the intent of purchasers in agreeing to area rate clauses to permit escalation to "the level of the generally applicable ceiling rate which has been established by *federal authorities,*" (emphasis added)

[30] *See, e.g.*, Statement of Mobil Oil Corporation, filed February 27, 1979, at 1, 2. Comments of Indicated Producers, filed February 27, 1979; Comments of Shell Oil Company filed February 22, 1979; and Statement of Independent Petroleum Association of America filed February 27, 1979.

rather than by the Commission.[31] Individual pipelines have expressed the same view.[32] [R. 1090]

Other pipelines have commented that it was their intent in acceding to the inclusion of an area rate clause in their own purchase contracts to permit escalation to the highest ceiling price of general applicability, whether set by the FPC or any other authority,[33] or to the highest ceiling permitted by law.[34]

A contrary interpretation was suggested by another pipeline company, however. Consolidated Gas Supply Corporation would interpret a clause which calls for escalation to a price prescribed by the Commission "or *successor* governmental authority" as *not* permitting escalation to NGPA prices. Its rationale is that by using such a clause the parties "clearly contemplated the fixing of rates through agency-type hearings".[35] Consolidated [R. 1091] Consolidated would, however, permit the operation of clauses worded to permit escalation to rates set by *other* governmental authority rather than the Commission or "*successor* governmental authority". The representative for Panhandle Eastern Pipeline Company went a step further, suggesting in oral argument on January 19, 1979,

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[31]Oral argument, January 19, 1979, in Docket No. RM79-23, Tr. 16, *See also,* Tr. 29; and INGAA's Comments filed February 27, 1979, at 2.

[32]*See, e.g.,* Comments of Michigan Wisconsin Pipe Line Company filed January 18, 1979, in Docket No. RM 79-3 at 1.

[33]*See, e.g.,* Comments of Natural Gas Pipeline Company of America, filed January 18, 1979, in Docket No. RM79-3, at 3.

[34]Comments of Texas Gas Transmission Company, filed February 27, 1979, at 3.

[35]Supplemental Comments of Consolidated Gas Supply Corporation filed January 31 1979, in Docket No. RM79-3, at 1; *see also,* oral argument January 19, 1979, Tr. 132.

that interpretation of the area rate clause isn't just a question of what the language says. It is also a question of what was in the minds of the parties when they entered into it . . . ."[36]

The State of Michigan and the Michigan Public Utilities Commission stated yet another position on the intent of contracting parties:

> Michigan wishes to stress that the interpretation of natural gas contracts must rest strictly on the language chosen by the parties for these agreements are not merely private bilateral contracts but are tariffs as well.

Michigan then goes on to say that the intent of parties, obvious under the plain meaning of the clause, is not to permit escalation to the NGPA rates.[37]

It is apparent from the comments received in this proceeding, that the wording of area rate and similar clauses varies widely, and interpretations may differ. The wording of a particular clause and the affect ascribed to that clause by the contracting parties will generally be determinative of whether a particular area rate clause authorizes the collection of the Natural Gas Policy Act prices. [R. 1092]

Nevertheless, in light of our administrative responsibilities under the Natural Gas Policy Act and the Natural Gas Act with respect to contractural matters, we believe it both necessary and appropriate to state some general views. At the outset, however, we wish to make it perfectly

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[36]Oral Argument, January 19, 1979, in Docket No. RM79-3, Tr. 100.

[37]Oral argument, February 27, 1979, in Docket No. RM79-22, Tr. 226.

clear that we do not intend to establish a *dispositive* view this matter. Several parties have cautioned us against that approach.[38] It is asserted that the record in this proceeding will simply not support a conclusive ruling on the operation of area rate clauses. We would agree. Accordingly, our views on this matter should be taken in the nature of "guidance".

The Commission recognizes that the parties to existing [R. 1093] interstate sales contracts are not the only parties in interest. As has been forcefully and correctly pointed out in these proceedings,[39] the gas consumer and the local distribution companies served by those pipelines have very direct and substantial interest in these matters. Nevertheless, as the courts have recognized in questions of contract interpretation, great weight must be given to the intent of the parties to the contract.[40]

After the fullest consideration of the comments received in this proceeding, it is clear that many parties to interstate sales contracts which contain area rate clauses were of the view that, by agreeing to an area rate clause, the parties intended to permit prices to escalate to the highest generally applicable ceiling rate alowed by governmental authority provided the rate was "just and reasonable" and the gas under the contract qualified for that rate. As stated by

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[38]*See in particular*, Comments of "Eight Independent Producers", filed February 27, 1979; Chevron U.S.A., filed February 26, 1979; and, Statement of Jack D. Head on Behalf of Texas Eastern Transmission Corporation and Transwestern Pipeline Company, filed February 27, 1979.

[39]*See*, oral presentation of New York Public Service Commission in oral argument before the Commission on February 27, 1979.

[40]*See, Louisiana-Nevada Transit Co.* v. *Woods*, 393 F. Supp. 177 (1975).

Michigan Wisconsin Pipe Line Company in its written comments:

> . . .[P]arties to interstate contracts generally believed that some form of governmental action would occur. The purpose of the area rate or FPC clauses was simply to permit the producer who committed his gas to the interstate market prior to such action occurring to benefit from such action provided that by governmental decision, he was otherwise permitted to do so. In short, parties agreed to make pricing a matter of governmental decision under circumstances where government chose to act.[41] [R. 1094]

The Commission is unable to conclude that this is an *unreasonable* interpretation of the intent of the parties to area rate clauses. Nor can we find a compelling public policy basis for precluding this interpretation. We would hold this view even if the area rate clause merely tracked the literal text of § 154.93(b)-(1). To the extent that such clauses reference action to be taken by other governmental authority the persuasiveness of this argument is strengthened. As noted earlier, we cannot find specific Congressional direction that we do so. And we find little basis for our imposing on the parties to the contract an interpretation which is contrary to the intent that they ascribe to their agreement simply on the ground that the rates were prescribed by the Congress and not by the Commission, or on the basis that the increased rate levels were not evolved through a cost-based rate methodology or

[41]Comments of Michigan Wisconsin Pipe Line Company filed January 18, 1979, in Docket No. RM79-3 at 1.

were not adequately cost justified.[42] Inasmuch as the Congress has determined to abandon cost-based methodologies in favor of statutory ceiling prices, we find it difficult to conclude that the Congress nonetheless intends this Commission in the exercise of its continuing authority under the Natural Gas Act to act, on its own motion, to prevent reliance on area rate clauses as contractual authority for the Natural Gas Policy Act ceiling prices in circumstances where both parties to the contract interpret their bargain to permit price escalation to those statutory ceiling prices. [R. 1095] [R. 1096]

Accordingly, in the first instance and as a general matter,[43] the Commission will give effect to the intention of

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[42]Another point should be made at this juncture. In the Notice of Proposed Rulemaking, the Commission stated that it did not *believe* that a reference to a "successor authority" could be interpreted to include the Congress. We now reverse that position. We find convincing the arguments that the Congress, in the exercise of direct ratemaking authority, has replaced and, in that sense, succeeded to the Commission's exercise of responsibility in this matter. On the other hand, we take cognizance that one party to a contract which contains an area rate clause, Consolidated Gas Supply Corporation, would interpret a clause which calls for price escalation to levels prescribed by the Commission "or successor Governmental authority" as not permitting escalation to the Natural Gas Policy Act prices. Consolidated's view is that it had contractually bound itself only to the outcome of agency-type hearings in which administrative protections not available in the legislative process were present. These would presumably include the opportunity to protest in an administrative proceeding, to require agency findings, and to obtain judicial review. Consolidated should not be precluded from pursuing that view of the matter. And the Commission intends no such result. We are simply withdrawing from the assertion that under a "plain meaning" construction of the contract the Congress could not be considered a "successor".

[43]95 Cong. Rec. H 13117 (daily ed. October 14, 1978). Statement of Congressman John D. Dingell.

the parties and permit reliance on area rate clauses for the requisite contractual authority in interstate sales contract to permit escalation to the Natural Gas Policy Act ceiling prices. This appears particularly appropriate in the case of the ceiling prices established under sections 104 and 106(a) of the Natural Gas Policy Act. While these prices are not specifically prescribed by the Commission in the same way area or nationwide rates were, the section 104 prices are based and inextricably linked to previously prescribed FPC rates. What the Congress did in enacting section 104 was to freeze as of April 20, 1977 the presently lawful FPC rates and to change the escalation factors from those established by the FPC to a different method required by the Congress.[44] [R. 1097]

As explained by Congressman Dingell on behalf of the House floor managers at the time the Natural Gas Policy Act was considered, the section 104 rates "incorporate by

[44]Ratemaking is a legislative function exercised under the interstate commerce clause of the United States Constitution, Art. I, § 8, clause 3. *Prentis* v. *Atlantic Coast Line Co.*, 211 U.S. 210, 226 (1908). *See also, Munn* v. *Illinois*, 94 U.S. 113, 133-34 (1877); *Ohio Valley Co.* v. *Ben Avon Borough*, 253 U.S. 287, 289 (1920); 253 U.S. 287, 289 (1920); *Morgan* v. *U.S.*, 279 U.S. 468, 279 (1936); *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 589 (1945). The Commission has exercised this function, by delegation from the Congress in the Natural Gas Act, with respect to producer sales since 1954. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954). By enacting the NGPA with the exception of the provisions in sections 104(b)(2), 106(c), 107(b) and 109(b)(2), which give the Commission the authority to set rates in excess of the NGPA ceiling prices, the Congress has rescinded that much of its rate-setting authority as it had delegated to the Commission under the Natural Gas Act. And the Congressional action provides legislatively set rates for the same period that would have been the subject of the latest Commission biennial review, thus obviating the necessity for this Commission to conclude or take further action with respect to that proceeding.

reference" the Commission-prescribed rates.[45] As Panhandle Eastern Pipeline Company and Trunkline Gas Company put the matter in their joint written comments, [R. 1098] "the section 104 rates are the historical, regulatory and contractual progeny of the just and reasonable rates resulting from the area rate proceedings under the Natural Gas Act".

As noted earlier the Commission does not intend to have its comments respecting the operation of area rate clauses be viewed as an attempt to speak in a dispositive way to this subject. Rather our intent is merely to express an *administrative* view of this matter to provide some guidance to the parties in interest as to how the Commission intends to discharge its responsibilities under the Natural Gas Policy Act and the Natural Gas Act. As the comments and these proceedings make abundantly clear, some parties ascribe a different interpretation to the operation of area rate clauses and it is the Commission's view that we must provide a forum to permit protest to be made to the utilization of area rate clauses as contractual authorization for the Natural Gas Policy Act prices.

D . Decision [R. 1099]

On the basis of the foregoing analysis, the Commission arrives at the following decisions:

1. Existing Interstate Sales Contracts.

To the extent that the Natural Gas Act remains applicable to an existing interstate contract, the provisions of § 154.93 of the Commission's regulations, which have

[45]The same is generally true of the section 106 price ceilings applicable to rollovers of interstate contracts, although here the Congress also added a specific formula which approximates previous FPC prescribed rates.

been promulgated under that Act, do not preclude the operation of price escalation provisions in a contract, the terms of which specifically permit escalation to Congressionally or legislatively authorized prices or which specifically reference Natural Gas Policy Act prices. Also, the Commission will, in the absence of specific contractual language to the contrary, generally interpose no objection to the parties to an interstate contract ascribing an interpretation to an area rate clause in its contract as would authorize escalation to, and collection of, the Natural Gas Policy Act price ceilings.

In the event that interstate pipeline purchasers contest the use or reliance by sellers on area rate clauses in their contracts, the Commission will provide an opportunity to protest. Once a protest to contractual authorization is submitted, the Commission will then consider the matter and attempt to state its view. Other parties in interest, including state commissions, local distribution companies and aggrieved parties will be permitted to participate in any such proceeding. [46] Also, such parties may protest the [R. 1100]

[46]The process of determining whether the subject contract authorizes the rate increase could take many forms. Some guidance can be gleaned from our handling of similar questions under the Federal Power Act. In those instances where a contract-based challenge is raised, the Commission has resolved the question in one of two ways. If the protest asserts that the contract language is sufficient to resolve the matter, then the Commission has in the past examined the language in light of its experience and the arguments raised in the protests and rendered a decision. Where, however, the protest asserts that the language itself is not sufficient and parole evidence is needed, for example, because action of the parties subsequent to execution of the contract has modified the contract or the contract is ambiguous, then the Commission has entertained additional pleadings on the contested matter. *(See, Gulf States Utilities* v. *FPC,* 518 F.2d 450 (D.C. Cir. 1975); *Appalachian Power Co.* v. *FPC,* 529 F.2d 342 (D.C. Cir. 1976); *Indiana & Michigan Electric Co.* v. *FPC,* 530 F.2d 1060 (D.C. Cir. 1976)). The Commission generally has not found it necessary to resort to formal, adjudicatory hearings to decide these cases but that

utilization of area rate clauses even in the face of agreement among the parties to the contract as to the interpretation which should be ascribed to such clauses. In this [R. 1101
event, however, the Commission advises that considerable weight will be given to the interpretaion ascribed to the contract by its parties.

Because it is the Commission's general view that area rate clauses may be relied on by the parties to a contract as authority for an increase in rates to Natural Gas Policy Act statutory ceilings, and specifically because our analysis suggests that area rate clauses would appear to have been triggered at least with respect to the rates under sections 104 and 106(a) of the Natural Gas Policy Act, the Commission concludes that it is neither necessary nor appropriate to revise our blanket affidavit procedures provided in Commission Order Nos. 15 and 15-A (§ 154.94 of the Commission's regulations under the Natural Gas Act) other than to extend the date for filing a protest. That section of our regulations currently provides that "neither the filing of a blanket affidavit nor the acceptance for filing of such an affidavit by the Commission, will affect any person's contractual right to purchase natural gas at a rate which is less than the applicable maximum lawful price under the Natural Gas Policy Act."[47] Also, the *Mobile-Sierra* line of cases makes clear that a rate increase under [R. 1102

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course of action may be appropriate in some circumstances. A protest petition should make specific reference to the applicable producer rate schedule (i.e. contract), assert the basis for the protest, and supply such further information as the protestant believes will assist the Commission or is relevant to the question. How the Commission will proceed from that point to dispose of the case is a decision that can only be made on a case-by-case basis. Further, the Commission expresses no opinion at this time on the evidentiary standard that may be imposed or the standard of review that may be employed by the Commission in deciding these issues.

[47]Section 154.94(h)(7).

the Natural Gas Act in the absence of contractual authority is a "nullity" whether the rate was accepted by the Commission or not. [48]

Accordingly, if it is ultimately determined on the basis of a final nonappealable order of this Commission, or if it is ultimately found by a court, that an area rate clause did not, in fact, provide the requisite contractual authority for the rate increase, the producer would be under the obligation to return the monies collected for which there did not exist contractual authority and, under standard PGA provisions, these monies would be required to be flowed-through to the consumer. It is our view, moreover, that the standard rate of interest applicable to refunds under Commission regulations would apply to any such amounts required to be paid back and flowed-through to purchasers. Accordingly, in any case in which a challenge is made to the utilization of or reliance on an area rate clause as authorization to collect the Natural Gas Policy Act statutory rates, it is unnecessary for the Commission to specifically suspend and require that the amounts in dispute be collected subject to refund.

Thus, the Commission will establish a general protest procedure in which parties in interest can petition the Commission for a specific determination as to whether a particular contractual clause constitutes the requisite authority to charge and collect Natural Gas Policy Act rates. In light of the administrative difficulties, complexities and general practical problems which attend the transitional period, the Commission will amend its protest procedures contained in § 154.94 to allow for filings of protests within the later of 90 days after filing of an affidavit, or May 1, 1979. Similarly, protest to interim and [R. 1103]

[48] *See*, n. 13, *supra* at 13.

retroactive collection filings may be filed within the later of 90 days of the filing of notice to the Commission, or May 1, 1979.[49] The Commission, for practical administrative reasons and in order to give some certainty to these matters, will not entertain protests filed after that date. Of course, parties in interest may still be able to resort to the courts to seek resolution of the question.

2. Existing Intrastate Sales Contracts. [R. 1104]

As a general matter, fixed price and indefinite price escalator clauses in existing intrastate contracts may permit escalation of the price under the contract in accordance with the terms of that contract. In a case where section 105(b)(1) of the Natural Gas Policy Act applies, escalator clauses may permit an increase in the contract price up to but not in excess of the current new natural gas price under section 102 of the Natural Gas Policy Act.[50] Questions of contract interpretation are left, in the first instance, to the parties to the contract. In the event of their disagreement, the question should be left to state courts to resolve.

Of course, where section 105(b)(1) applies, while the matter of contract interpretation of existing intrastate contracts is generally to be left to the parties, the parties cannot ascribe an interpretation to their contract which contradicts or is inconsistent with the terms of the contract as

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[49]The Commission notes that under the Natural Gas Act, a unilateral rate increase filing inconsistent with the applicable contract between the parties is invalid, and need not be suspended within 30 days after it is filed.

[50]If, however, the producer claims eligibility for a price higher than the 105(b)(1) price – *e.g.*, the price under section 108, escalator clauses may be relied on to obtain the higher price for that production which is determined to qualify for the higher price.

they were in effect on November 9, 1978 (the date of enactment of the Natural Gas Policy Act).

In order to give some guidance to the parties on how the Commission intends to discharge its administrative and enforcement responsibilities pursuant to section 501 of the [R. 1105] Natural Gas Policy Act, the Commission believes it must responsibly address the question of the operation of FPC-type clauses. Consistent with our discussion and analysis of this matter concerning area rate clauses in interstate contracts of which FPC-type clauses are the functional equivalent, it is our view that the parties may interpret such clauses (consistent with their terms) as providing contractual authority to escalate to applicable Natural Gas Policy Act statutory prices.

Finally, because the Commission has revised its view concerning the operation of area rate clauses and FPC-type clauses in existing interstate and intrastate contracts, the Commission will not give further consideration at this time to the issues raised in the proposed rulemaking concerning the authority of the parties to these contracts to amend their terms. Such questions will be addressed in a subsequent interpretative order of the Commission.

IV. EFFECTIVE DATE

The amendments discussed above will be effective [R. 1106] immediately, pursuant to a finding of good cause under 5 U.S.C. § 553(d)(3). According to industry practice, producers, under ordinary circumstances would have billed in *January 1979 for deliveries made in December 1978,* the effective date of the ceiling prices under the Natural Gas Policy Act. This order has a significant impact on the amount that parties may lawfully bill for such deliveries. The Commission believes it is important to inform parties to natural gas purchase contracts concerning the amounts they are permitted to collect at the earliest possible mo-

ment. Accordingly, we believe that good cause exists to make these amendments effective immediately.

The Commission notes that the precise rules we are adopting have not been specifically included in a general notice of proposed rulemaking under 5 U.S.C. § 553(b). However, the original version of § 270.205 was published on December 1, 1978, and the public has had opportunity to file comments since that time. Moreover, the Commission has separately requested comments concerning § 270.205, issued a separate notice of proposed rulemaking, and held oral argument on January 19, 1979 and February 27, 1979, confined solely to issues concerning the [R. 1107] effect of the Natural Gas Policy Act on price escalator clauses in existing contracts. We believe that, through the above-described procedures, parties have received ample notice and have had sufficient opportunity to participate in the formulation of our decision.

APPENDIX [R. 1108]
Summary of Other Comments Respecting Interstate Contracts

This appendix attempts to identify other major comments which have been filed in this proceeding. The comments have addressed a number of issues in addition to that of contractual intent of the parties. Failure to refer to specific comments or arguments either in the body of the Commission's opinion or in this appendix should not be considered an indication that the comments have not been considered.

1. The Area Rate Clause in Interstate Contracts.

Several members of Congress have addressed themselves to the issue of Congressional intent. Among these is Senator Pete Domenici of New Mexico.[1] The Senator stated that his understanding of the Congressional intent was for existing area rate clauses to provide contractual authorization for collection of all prices under the Natural Gas Policy Act. The Senator reasoned that since section 601(b)(1)(A) of the Natural Gas Policy Act declares the ceiling prices established therein rates just and reasonable, area rate clauses encompass [R. 1109] these prices. The Senator also asserted that if producers are denied the ceiling prices under their existing contracts then those producers who drilled wells during 1977 and 1978 in reliance on the Commission's commitment to set a national rate for that biennium would be penalized.[2]

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[1] *See* Comments of Senator Pete Domenici filed January 18, 1979, in Docket No. RM79-3; *see also* Statement of Senator Pete Domenici filed February 27, 1979, in this docket, and oral argument February 27, 1979, Tr. 3-10.

[2] Statement of Senator Pete Domenici filed February 27, 1979, in Docket RM79-22, pp. 3, 4.

Representative Clarence Brown argues that section 101(b)(5) of the NGPA expressed Congressional intent to permit sellers to collect the highest price for which their natural gas is eligible.[3] To hold that escalation clauses prohibit such collection is, according to the Congressman, contrary to such Congressional intent.[4] The Congressman also represented that the proposed rule would prevent any natural gas which is now sold under existing interstate contracts from receiving the higher incentive prices established by sections 102, 103, 107 and 108. Congressman Brown asserts that as a result of the proposed rule, price disparity between natural gas sold in interstate and intrastate commerce will increase, in contravention of the Congressional policy of gradually abolishing the duality of price between the two markets.[5] [R. 1110]

Senator J. Bennett Johnston, Jr. also urged the Commission to permit sellers to collect Natural Gas Policy Act prices on the basis of area rate clauses. In support of this suggestion, he cites Congressional awareness that the Federal Power Commission had uniformly treated area rate clauses as authorizing payment and collection of new vintage rates.[6]

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[3]Section 101(b)(5) reads as follows:

> (5) SALES QUALIFYING UNDER MORE THAN ONE PROVISION: If any natural gas qualifies under more than one provision of this title providing for any maximum lawful price or for any exemption from such a price with respect to any first sale of such natural gas, the provision which could result in the highest price shall be applicable.

[4]Comments of Representative Clarence Brown filed January 18, 1979, in Docket No. RM79-3.

[5]*Id.*

[6]Comments of Senator J. Bennett Johnston, Jr. filed January 18, 1979, in Docket No. RM79-3.

Congressman David Treen, in remarks made at the Commission's February 27 oral argument, also stated that the proposed rule runs counter to Congressional intent. He argued that the statute specifically addresses the question of escalator clauses in three circumstances alone. Congressman Treen suggests that the specific references in these three situations, combined with the failure of the NGPA to include a general provision regarding escalator clauses, is evidence of Congressional intent for existing interstate contracts to authorize collection of NGPA prices.[7]

Congressman John D. Dingell provided an analysis of [R. 1111] the salient statutory provisions[8] and suggested several rationales upon which the Commission could permit collection of the NGPA ceiling prices. In his remarks, Congressman Dingell noted that the section 104 prices were designed to take the FPC determined wellhead prices and keep them constant in real dollars by escalating the prices monthly to account for inflation. He urged the Commission to construe area rate clauses as authorizing the collection of the section 104 prices. Chairman Dingell also noted that the incentive prices under sections 102, 103 and 107 would apply to natural gas determined to qualify for those prices. This natural gas would no longer be subject to the provisions and requirements of the Natural Gas Act pursuant to section 601. Therefore, he believes that even "impermissible" clauses can operate to authorize collection of such prices. Contractual amendments would also be permitted. Finally, with regard to section 108, the Congressman would suggest that area rate clauses are triggered to permit collection of the 108 price under a reading of sections 101(b)(6) and 601(b)(1).[9]

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[7]Oral argument February 27, 1979, Tr. 21-23.

[8]Comments filed January 19, 1979, in Docket No. RM79-3.

[9]*Id.*

The Secretary of Energy, James R. Schlesinger, also [R. 1112]
filed comments in this proceeding discussing Congressional intent.[10] The Secretary stated that based upon the policy purposes of the statute (to create a national market as well as to provide increased domestic prices) the Commission should not interpret area rate clauses as proposed in the rule. Rather, the Secretary stated, that by force of the Commission's own regulations there was only one alternative for producers to utilize to contract for higher prices in the future: area rate clauses. The Secretary noted that all studies anticipated that these clauses would permit collection of the ceiling prices, including section 108 prices but especially section 104 prices.

Representative Toby Moffett[11] and Senator Jim Sasser,[12] on the other hand, support the Commission's proposed rule as it applies to area rate clauses in interstate contracts. Congressman Moffett states that the proposal is consistent with Congressional intent as expressed on page 83 of the Statement of Managers. He further suggests that incentive prices, as embodied in sections 102, 103, 107 and [R. 1113]
108 of the NGPA, are not applicable to currently flowing gas.[13] Senator Sasser cites the Conference Report for the proposition that the statutory rates are only ceiling prices.[14]

Other parties cited Congressional intent in support of the proposed rule. For example the Public Utilities Commission of the State of California referred to the discussion at page 83 of the Statement of Managers as evidence

[10]Comments of James R. Schlesinger, Secretary of Energy filed February 26, 1979 in Docket No. RM79-3.

[11]Comments of Representative Toby Moffett filed February 27, 1979.

[12]Comments of Senator Jim Sasser filed February 27, 1979.

[13]Comments of Representative Toby Moffett, at p. 1

[14]Comments of Senator Jim Sasser, at p. 2.

that "the bill's drafters were familiar with and approved of the bar against indefinite price escalator clauses in interstate contracts as then enforced by the Commission."[15] Comments filed by a group of gas consumers cite section 101(b)(9) of the statute as evidence that Congress did not intend to supersede contract prices,[16] and argue that area rate clauses do not permit collection of maximum lawful prices under the Natural Gas Policy Act.

2. Continued Natural Gas Act Jurisdiction

In response to comments by many of the participants in this proceeding,[17] we expressly note the effect of section 601(a)(1) of the Natural Gas Policy Act on certain types of committed or dedicated natural gas. That provision provides that the Commission's Natural Gas Act jurisdiction over committed or dedicated natural gas ceases as to first sales under section 102(c), 103(c) and 107(c) of the statute. Therefore, once a determination of eligibility under the above sections becomes final, the Commission's authority under the Natural Gas Act to limit or otherwise regulate the operation of contractual provisions terminates. The comments point out that this result applies both to previously impermissible clauses and area rate clauses. [R. 1114]

3. Variant Clauses

Reference in the proposed rule to "variant clauses" has engendered considerable comment. The original Commis-

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[15]Comments of the Public Utilities Commission of the State of California, filed February 27, 1979 at 3.

[16]Comments of Indicated Intrastate and Interstate Gas Consumers, filed in Docket No. RM79-3, Attachment B at 2.

[17]*See, e.g.*, New York Public Service Commission comments filed February 27, 1979 at 7; *see also*, Statement of Shell Oil Company filed February 27, 1979, at 24-26; Statement of the Honorable John D. Dingell filed January 19, 1979.

sion view was that a "variant clause" – any escalation provision that does not precisely reflect the precise language of § 154.93 (b-1) – was inoperative to the extent its scope exceeded that of the permissible area rate clause.

In response to the comments received, the order has been revised to permit "variant clauses", which by their terms are triggered by passage of the Natural Gas Policy Act or which provide for escalation to the highest applicable rate prescribed by legislation to be operative according to their terms.[18] The notice issued on February 13, 1979 suggested that such clauses were in violation of §154.93, and therefore would not be given effect. [R. 1115]

4. **Contract Amendment**

The Commission's Notice of Proposed Rulemaking stated that although area rate clauses did not constitute contractual authorization for the statutory ceiling prices, the parties to existing interstate contracts could amend their agreements to provide for the payment and collection of any applicable maximum lawful price. The Commission further provided that any such amendment would be permitted to operate retroactively to December 1, 1978, and that interstate pipelines would be permitted to pass through increased costs attributable to contract amendments so long as the modification was agreed to in arms-length bargaining, and provided the Commission did not find "fraud, abuse or similar grounds" existed.

This particular aspect of our proposal has been the subject of a great deal of critical comment. Representative Toby Moffett stated that our "proposals allowing retroactive treatment to December 1, 1978 raise serious problems. The legislative history and the views expressed by Con- [R. 1116]

[18] *See*, Comments of the New York Public Service Commission filed February 26 1979 at 7. *See also*, Comments of Chevron, U.S.A., Inc., filed February 27, 1979, at 6.

ferees in public meetings showed a strong desire to protect contract sanctity."[19] The Congressman further suggested that it is "unreasonable to expect customers to pay additional prices for gas already delivered."[20]

Other criticism expressed concern from a different point of view. For example, the New York Public Service Commission, citing the *Mobile-Sierra* doctrine, argued "[I]t is clear that contractually authorized rate increases cannot be made effective retrospectively and . . . only the filed rate can be charged."[21] The Michigan Public Service Commission[22] and others[23] made the same argument. New York also argues that the retroactive amendment proposal [R. 1117] is inconsistent with the NGPA and other Interim Regulations issued thereunder. New York states that, although section 601(a)(1)(B) of the statute makes the Natural Gas Act inapplicable to certain committed or dedicated gas, the Natural Gas Policy Act itself requires that there be contractual authorization at the time deliveries of gas are made. New York further states that, although the Conference Report (at page 120) mentions retroactive collection of Natural Gas Policy Act ceiling prices in certain circumstances, it does not permit the Commission to authorize retroactive contract amendments.[24] New York

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[19]Comments of Representative Toby Moffett, filed February 27, 1979 at 2.

[20]*Id.*

[21]Comments of the New York Public Service Commission filed February 26, 1979 at 8, citing *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951).

[22]Comments of the State of Michigan and the Michigan Public Service Commission filed February 27, 1979 at 5-7.

[23]Comments of the South Dakota Public Utilities Commission and the Minnesota Public Service Commission, filed January 31, 1979 in Docket No. RM79-3, at 2, 3.

[24]New York Comments, *supra*, at 9, 10.

also rejects the FERC's attempt to justify retroactively on equitable grounds.[25]

Laclede Gas Company stated that the Commission should not rely upon contractual amendment to circumvent its policy determination. Laclede urges the Commission to decide the issue unequivocally and "not pass the responsibility, and liability, for decision on to the Nation's pipelines."[26]

5. **Pipeline Passthrough**

Many participants have criticized the proposed rule's approach to pipeline passthrough of increased costs resulting from contract amendments. The Commission proposed that it would permit passthrough of these costs so long as the modifications were the result of "arms-length bargaining," and provided that there was no "fraud, abuse, or similar grounds". Comments on this issue range from assertions that the rule, although conceptually sound, provides insufficient guidance, to statements that the proposed policy is unjustifiable on its merits. [R. 1118]

Associated Gas Distributors (AGD) argue that the Commission should provide a working definition of arms-length bargaining which among other things recognizes that adequate consideration is needed to support a bona fide contract amendment.[27] AGD also would place the

[25] *Id.* at 9. New York is referring to the Commission's statement in the notice of proposed rulemaking that since the enunciation of the Commission's policy concerning area rate clauses did not come until after the effective date of the NGPA, contract amendments made in response to the rule should be permitted to operate retroactively to that date.

[26] Comments of Laclede Gas Company filed February 27, 1979 in Docket No. RM79-22, p. 3

[27] *See,* Comments of Associated Gas Distributors filed Fbruary 27, 1979 in Docket No. RM79-22.

burden of showing adequate consideration on the producer-seller. Alabama Gas Corporation and Indicated Intrastate and Interstate Gas Consumers also support the [R. 1119] view that adequate consideration is necessary to effect a valid contract amendment.[28]

The majority of interstate pipelines filing comments in this proceeding agreed that the intent of the parties to the contract was controlling. However, many of the pipelines were concerned that they be guaranteed the passthrough of payments made pursuant to a contractual amendment. The interstate pipelines were also concerned with the meaning of the term "arms-length" transactions.[29]

The Commission has reconsidered its opinion in light of the comments filed and in consideration of the Commission's opinion that contractual intent of the parties control. By effectuating the intent of the parties, the need for contract amendment decreases substantially. The Notice of Proposed Rulemaking would have permitted such amendments to operate retroactively to December 1, 1978, provided the parties agreed to such retroactivity. The Commission explained that fairness to the parties required [R. 1120] that we permit such retroactivity. Several comments expressed the view that the Commission would be acting beyond the scope of its authority in permitting contract amendments to operate retroactively. The action we are taking today, in giving effect to the intent of the parties, obviates the need to address the retroactivity of any amendment.

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[28] *See*, Comments of Alabama Gas Corporation filed February 27, 1979 in Docket No. RM79-22, and Comments of Indicated Intrastate and Interstate Gas Consumers Regarding Proposed Rules filed February 27, 1979 in Docket No. RM79-22.

[29] *See, e.g.*, Natural Gas Pipeline Company of America filed February 27, 1979 in Docket No. RM79-22; Comments of Texas Gas Transmission Corporation filed February 27, 1979 in Docket No. RM79-22 and Comments of Interstate Natural Gas Association of America filed February 27, 1979 in Docket No. RM79-22.

6. State Jurisdiction

The State of Michigan and the Michigan Public Service Commission (Michigan), both in written comments[30] and at ora' argument, have suggested that the FERC speak to the relationship of our action in this docket to the jurisdiction of state regulatory agencies. Michigan states that the proposed rule fails to acknowledge the jurisdiction of the states to restrict or regulate the operation of escalator clauses in interstate commerce. The order of the Commission does not deal with this question, but we wish to make clear, if there is any doubt it is not our intention to intrude into the jurisdiction that the Congress has left to the states to establish lower ceiling prices with respect to production occurring in that state.[31]

7. Comments on Intrastate Contracts [R. 1121]

Several parties have commented concerning the application of the proposed rule and the Commission's underlying discussion to existing intrastate contracts. The Southern Union Company, a New Mexico distribution company, asserts that the effect of the proposed rule will be to discourage production on undeveloped acreage which is subject to existing intrastate contracts. Southern Union states that it is a party to a number of contracts with no escalation provisions, or with nominal fixed escalations. If such a contract is subject to section 105(b)(1) of the Natural Gas Policy Act, it may not be amended to effect a price increase above the price paid on November 9, 1978. Accordingly, Southern Union argues a producer would be unwilling to dedicate additional undeveloped acreage to the contract.[32]

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[30]Comments filed February 27, 1979, in Docket No. RM79-22 at 7, 8; Tr. at 295.

[31]See section 602, Natural Gas Policy Act.

[32]Comments of Southern Union Company, filed February 27, 1979, at 2-4.

Indicated Consumers disagree with the proposed rule to the extent that it would permit a seller of gas to receive a price above the section 102 price. Indicated Consumers argue that section 105 sets a mandatory price ceiling which may not be exceeded even for particular wells which qualify under various other Title I wellhead pricing provisions. Indicated Consumers further argue that to the extent the ommission leaves interpretation of contracts to the parties is violating section 501(a) of the Natural Gas Policy Act which calls for the FERC to administer the statute. [R. 1122]

Mountain Fuel Supply Company states that in some circumstances the proposed rule would discriminate against the intrastate market. If a producer has an intrastate contract subject to section 105(b)(1) of the Natural Gas Policy Act that contains an FPC clause and no other escalation provision, he would be unable to amend his contract to collect higher statutory prices. An interstate seller could, however, amend his contract and collect prices under sections 102, 103, 107 and 108.[33] On a related issue, Hawthorne Oil and Gas Corporation takes exception to our proposed interpretation of FPC clauses which refer to "successor governmental authority".[34] Northwest Arkansas Producers Group suggests that this interpretation is inconsistent with the general intention of the Commission, expressed at page 40 of the Notice, to leave initial interpretation of intrastate contracts to the parties.[35] [R. 1123]

Mesa Petroleum Company also criticized this interpretation. Mesa asserts that it is illogical for the Commis-

[33]Comments of Mountain Fuel Supply Company filed February 27, 1979, at 6. Lone Star Gas Company also raised this question in its comments filed February 27, 1979, at page 4.

[34]Comments of Hawthorne Oil and Gas Corporation, filed February 26, 1979.

[35]Comments of Northwest Arkansas Producer Group, filed February 26, 1979, at 3.

sion to interpret FPC clauses in intrastate contracts in the same way as area rate clauses in interstate contracts. To make such an interpretation merely for consistency's sake is, according to Mesa, to ignore the actual intent of the parties. While intent of the parties to an interstate contract may be construed in light of FPC regulations, such is not the case with intrastate contracts. Mesa states, "Parties negotiating an intrastate contract were not inhibited by . . . regulatory restraints; their concern was to contract for the best possible price initially and, during the term of the contract, a price at least as high as any seller in the interstate market was permitted charge."[36]

Finally, as the order notes, the Commission has revised its view concerning the operation of area rate clauses and FPC-type clauses in existing interstate and intrastate contracts, therefore, the Commission will not give further consideration at this time to the issues raised in the proposed rulemaking concerning the authority of the parties to these contracts to amend their terms. Such questions will be addressed in a subsequent interpretative order of the Commission. [R. 1124]

(Natural Gas Act, as amended, 15 U.S.C. 717, *et seq.*, Natural Gas Policy Act of 1978, P.L. 95-621, 92 Stat. 3350, E.O. 12009, 42 F.R. 46267).

In consideration of the foregoing, Part 154 of Subchapter E and Parts 270 and 273 of Subchapter H, Chapter I Title 18, Code of Federal Regulations, are amended as set forth below, effective immediately.
By the Commission. Commissioner Holden voted no.

/s/Kenneth F. Plumb,
Secretary.

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[36]Comments of Mesa Petroleum Company, filed February 26, 1979, at 5.

1. Section 154.94 is amended in paragraph (h)(7) by adding at the end thereof the following new sentence; "For special rules respecting contractual authorization to collect NGPA rates, see § 270.205." [R. 1125]

2. Section 154.94 is amended by revising subparagraph (8) of paragraph (h) to read as follows:

§ 154.94 **Changes in rate schedules.**

(h) **Blanket filing.**

* * *

(8) **Protest procedure.** Any protest to an affidavit required to be filed under this paragraph shall be filed within 90 days of the filing of such affidavit or May 1, 1979, whichever is later.

3. Section 154.94 is amended by revising paragraph (i) to read as follows:

§ 154.94 **Changes in rate schedules.**

* * *

(i) **Interim and retroactive collections.**

(1) **Filings.** Compliance with the applicable filing requirements imposed by §§ 273.201(c), 273.202(d), 273.203(c), and 273.204(c)(3) shall be deemed to satisfy the requirements of paragraph (b) of this section and section 4(d) of the Natural Gas Act for first sales of natural gas to which the Natural Gas Act remains applicable and for which an interim or retroactive collection is authorized by Part 273. The 30 day notice otherwise required by section 4(d) of the Natural Gas Act is waived.

(2) **Contractual authorization.** Neither the filing described in clause (1) nor the acceptance of such filing by the Commission, will affect any person's contractual right to purchase natural gas at a rate which is less than the applicable maximum lawful price under the NGPA. [R. 1126]

(3) **Protest.** Any protest to a filing under clause (1) shall be made no later than 90 days after such filing is

made, or not later than May 1, 1979, whichever is later. If protest is made with respect to a filing under clause (1), on the grounds of lack of contractual authorization, then notwithstanding § 273.302(f), any refund obligation under § 273.302 shall continue until contractual authorization is established or until refund is made in accordance with the direction of the Commission.

(4) Section 270.205 is amended to read as follows:

§ 270.205 Contractual authorization to collect NGPA rates.

(a) Existing interstate contracts. In the case of an existing contract for a first sale of natural gas to which the Natural Gas Act applies:

(1) Any contractual provision for a change in price in such contract which by its terms specifically permits collection of NGPA rates or of maximum lawful prices prescribed by legislation, constitutes constractual authorization to charge and collect the NGPA rates applicable to such first sale.

(2) A contractual provision described in § 154.93 (b-1) (relating to area rate clauses), or similar provision, generally will be considered to constitute contractual authorization to charge and collect an NGPA rate to the extent the parties intended to authorize charging and collection of one or more NGPA rates under the contract. [R. 1127]

(b) Existing intrastate contracts. In the case of an existing contract (other than a contract to which paragraph (a) applies):

(1) Except as provided in paragraph (b)(2), any contractual provision for a change in price may operate according to the terms of such provision except that such provision is not operative to authorize a seller to charge and collect an amount in excess of the highest applicable NGPA rate.

(2) If natural gas sold under such contract is subject to section 105(b)(1) of the NGPA and qualifies for no higher maximum lawful price, no contractual provision for a

change in the price under such contract may operate to permit a price under the contract in excess of the new natural gas price under section 102 of the NGPA.

(c) **Definition.** For purposes of this section, "NGPA rate" means maximum lawful price prescribed by or under the NGPA (including any price collection of which is authorized by Part 273). [R. 1128]

5. Section 273.104 is amended to read as follows:

§ 273.104 **Cross references.**

(a) For special rule applicable to resellers, see § 270.202(b).

(b) For special rules relating to contractual authorization to make interim and retroactive collections, see § 270.205.

(c) For special rule relating to refund obligations where contractual authorization is not established, see § 154.94(i)(3).

UNITED STATES OF AMERICA [R. 1376]
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Charles B. Curtis, Chairman;
Don S. Smith, and George R. Hall.

Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act	)))))	Docket No. RM79-22

ORDER ON REHEARING
OF ORDER NO. 23
(Issued May 11, 1979)

I. Introduction

On March 13, 1979, the Federal Energy Regulatory Commission (Commission) issued Order No. 23. That order addressed the question of the contractual authority to collect a maximum lawful price under the Natural Gas Policy Act of 1978 (NGPA), and the Commission's responsibility under that act and the Natural Gas Act (NGA) to examine questions of contractual authority. The Commission has previously responded to two requests for clarification,[1] and a motion for emergency procedural relief[2] filed herein.[3] Additionally, eighteen applications for rehearing or Order No. 23 were filed.

[1]The New York Public Service Commission, joined by Associated Gas Distributors, requested clarification.

[2]The Associated Gas Distributors filed this motion.

[3]Order Extending Time to File Protests and Clarifying Prior Order, issued April 30, 1979.

This order denies these applications for rehearing.[4]

II. DISCUSSION [R. 1377]

Excluding questions of procedure, the petitions for rehearing raise no matters of fact or arguments of law which would cause the Commission, acting within the narrow confines of its substantive review, to change the basic findings of Order No. 23. However, although this order denies the applications for rehearing insofar as they relate to the substance of Order No. 23, the Commission takes this opportunity to expand and further clarify its position. This expression is limited to the two major concerns which appear to have caused the most confusion among the applicants for rehearing: the scope of the Commission's duty to examine contracts, and the applicable rules of law which will be applied to those contracts which the Commission does examine.

A. *Scope of the Commission duty to examine contractual authority.*

The Commission's statutory responsibility to examine contracts covering gas subject to the NGA was established by the Supreme Court.[5] The rule laid down by the Court, which has come to be known as the *"Mobile-Sierra* doctrine", has two components: (1) the NGA does not give a natural gas company the power to make a unilateral rate change filing absent contractual authority (*Mobile*); and (2) the NGA does not authorize the collection of a "just

[4]The parties who filed applications for rehearing are listed in the Appendix. To the extent the applications for rehearing raise procedural issues, the Commission will consider them as if they were made in response to our Notice of Inquiry issued herein on May 2, 1979.

[5]*United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S 332 (1956); *Federal Power Commission* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

and reasonable" rate absent contractual authority (*Sierra*). Thus, the *Mobile-Sierra* doctrine plainly applies to contracts for the sale of natural gas subject to the jurisdiction of the Commission under the NGA. Just as plainly the *Mobile-Sierra* doctrine does not apply to contracts for the sale gas not subject to the Commission's jurisdiction under the NGA.[6]

However, natural gas, which is not subject to our NGA jurisdiction, is nonetheless subject to our jurisdiction under the NGPA. And, for certain categories of "non-NGA" gas, NGPA Title I ceiling prices are based on contractual provisions.[7] For these categories of gas, the Commission is not the proper forum to adjudicate contractual disputes. Those parties who wish to resolve contractual disputes involving gas covered by sections 105 or 106(b), or gas which is otherwise not covered by the NGA, should petition the appropriate state or federal court. The Commission will limit its involvement in these matters to the statutory enforcement responsibility imposed by Title V of the NGPA. [R. 137

B. *Order 23 and Contract Law*

Several applications on rehearing, citing cases which adhere to the "plain meaning rule" of contract interpretation, contended that our *administrative* view, that "great

[6]Order No. 23, at page 14, stated: "Accordingly, the *Mobile-Sierra* doctrine requires the Commission to determine whether contractual authorization exists for the collection of the maximum lawful prices established by the Natural Gas Policy Act." That sentence should be further modified to indicate that the *Mobile-Sierra* requirement does *not* apply to gas which is no longer subject to the Commission's jurisdiction under the NGA. *See, e.g.* section 601(a)(1)(B) of the NGPA

[7]See sections 105 and 106(b).

weight must be given to the intent of the parties to the contract", is erroneous as a matter of contract law. That rule holds that, if contract language is clear and unambiguous, the contract must be interpreted by reference to the contract alone, and extrinsic evidence is inadmissible.

The viability of this view has been challenged by a more modern theory which permits a contract to be interpreted by reference to evidence of the commercial context in which it was drafted.[8] The Commission adopts this mode of analysis in this instance. Accordingly, where the Commission must rule on the proper interpretation of a contract clause, references will be made not only to the "four corners" of the contract, but also to the circumstances surrounding the execution of the contract.[9] [R. 1379]

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[8] *See: Whitebird v. Eagle-Picher Co.*, 390 F.2d 831 (10th Cir. 1969); Uniform Commercial Code, § 2-202; Restatement (Second) of Contracts, § 246 (Tent. Draft 1973).

[9] Part of the "commercial context" which the Commission will consider is the limitation imposed upon the parties by § 154.93 of the Commission's regulations. This limitation was not before the Supreme Court when it decided *Texas Gas Corp. v. Shell Oil Co.*, 363 U.S. 263 (1959). In *Texas Gas*, the Court found that the producer had drafted broader "most favored nation" clauses in other contracts, and that the most "reasonable explanation" for the narrower provision in the contract under dispute was an intent to distinguish between events which would or would not trigger the clause. Based on this "explanation", the Court found that the clause was not triggered. However, any contract executed on or after April 2, 1962 cannot contain an escalator clause broader than that permitted by § 154.93 of the Commission's regulations. The regulatory prohibition against broader escalator clauses may "reasonably explain" why area rate clauses were drafted as they were after April 2, 1962.

The Commission orders:

The applications for rehearing of the Commission's Order No. 23, issued March 13, 1979, are denied.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

UNITED STATES OF AMERICA [R. 1490]
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Charles B. Curtis, Chairman; Georgiana Sheldon, Matthew Holden, Jr. and George R. Hall.

Amendment and Clarification of Interim Regulations Under the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act	)))))	Docket No. RM79-22

ORDER NO. 23-A
(Issued June 12, 1979)

Introduction

This interpretative rule addresses the extent to which existing contracts for the sale of natural gas may be amended to provide for the payment of some or all of the prices established under the NGPA. The Commission has considered this question in Docket No. RM79-22, the proceeding which resulted in Order No. 23, relating to the effect of the NGPA on price escalator clauses. In a proposed rule issued February 13, 1979, we took the same substantive position on contract modifications as we now adopt. The comments on the proposed rule which were relevant to this subject did not, as a general matter, disagree with that position. Rather, the comments were directed at the related question of pipeline pass-through discussed below.

General Rule

Section 101(b)(5) of the NGPA provides that if any natural gas qualifies under more than one maximum lawful price, the highest price for which the gas is eligible [R. 1491] becomes the applicable maximum lawful price. The Commission believes contractual amendments consistent with

this section are permitted in both interstate and intrastate contracts. The most common, though not the only example of situations arising under the NGPA which illustrates this principle is when natural gas from a well subject to an existing contract is subsequently determined to be eligible for a higher price under sections 102, 103, 107 or 108 of the Act. If this occurs, the NGPA does not preclude parties from negotiating for and executing amendments providing for the payment of the higher price. This is true without regard to whether the contract was an "interstate" or "intrastate" contract.

Although the rule stated above applies in all cases, special attention should be given to contracts governed by section 105(b)(1) of the NGPA. That section applies to intrastate contracts under which the contract price on November 9, 1978, did not exceed the new gas price established in section 102 of the Act. For these contracts the maximum lawful price is the price under the terms of the contract as such contract was in effect on November 9, 1978.

With respect to these contracts, amendments may only be executed to provide for payment of any higher maximum lawful price for which natural gas sold under the contract is determined to be eligible. For example, assume that on November 9, 1978, natural gas was sold under an existing intrastate contract for $1.50/MMBtu, (or any [R. 1492] price less than $2.06, the new natural gas price in November). Since under section 105(b)(1), the price under the terms of the contract, ($1.50 per MMBtu) is the maximum lawful price, no contractual amendment could provide for a higher price. But if subsequent to enactment a well covered by the contract was determined to be stripper well, under section 101(b)(5) the gas from that well would be eligible under both sections 105(b)(1) and 108. In that case the applicable maximum lawful price would be the

stripper well price. Accordingly, an amendment providing for the payment of that higher price would be permitted. The same result would occur any time gas sold under the contract was determined to be eligible for any price higher than $1.50 per MMBtu (e.g., 102 new natural gas or 103 new onshore production well gas).

The operation of the rule on contracts governed by section 105(b)(2) of the Act is also worth noting. In these cases, the contract price exceeded the section 102 price on November 9, 1978, and the applicable maximum lawful price exceeded $2.06. Under section 105(b)(2), the ceiling price is the contract price plus the monthly inflation adjustment. Accordingly, if the contract did not already permit it, amendments to contracts subject to the maximum lawful price in 105(b)(2) could be executed to provide for the payment of the inflation adjustment. Also, amendments could be executed to provide for payment of the stripper well price established in section 108 of the NGPA, if wells covered by the contract were determined to be eligible of that price.

Other general examples may be helpful. If contractual authorization does not exist in an interstate contract to collect the inflation adjustment provided in section 104 of the Act, the NGPA does not preclude an amendment providing for its payment. Similarly, the NGPA does not preclude amendments to interstate contracts to provide for the payment of prices under sections 102, 103, 107 and 108 if natural gas under the contract qualifies for those prices. [R. 1493]

Two associated points should be noted. First, since collection of the higher price may be contractually authorized, amendments providing for the interim collection of such prices, pursuant to Part 273 of the regulations, are similarly permissible. Second, for the same reasons, all contracts may be amended to provide for a clause authorizing the payment of the highest NGPA price for

which any natural gas sold under the contract may become eligible, i.e., both interstate and intrastate contracts may be amended to include escalator clauses which reference the highest applicable NGPA prices.

Pass-through of NGPA Prices

In the preamble to the February 13, 1979, proposal, we indicated that pass-through of increased gas purchase costs resulting from contract modifications providing for a price not in excess of the maximum lawful price is permissible in the absence of fraud, abuse, or similar grounds. We also indicated that pass-through would not be precluded if modifications were negotiated in an arms length transaction.

A number of participants in Docket No. RM79-22 suggested that the Commission afffirmatively state that contract modifications must be supported by additional consideration. Other comments suggested that the Commission define arms-length bargaining. Upon consideration of these comments, we have determined that it is neither useful nor necessary to impose the requirement or define that term. We note particularly the difficulties of defining arms-length bargaining because of the wide diversion of views expressed on this point. Accordingly, we are convinced that we should abandon our previous reference to that test. [R. 1494]

Section 601(c)(2) of the NGPA provides that the Commission may not deny an interstate pipeline the recovery of maximum lawful prices paid by the pipeline unless " . . . the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds." The Joint Statement (pg. 124) indicates that "[t]he conferees do not intend to guarantee passthrough of costs of natural gas purchases in cases of fraud or abuse as *determined by the Commission.*" [emphasis supplied] A number of comments requested that we define the term "fraud, abuse or similar grounds."

The statute and the statement quoted would permit the Commission to make the determination on a case-by-case basis, or to prescribe general rules defining in part or fully the phrase "fraud, abuse or similar grounds." We are aware that general guidance as to the circumstances that would constitute grounds for a determination of fraud abuse or similar grounds would be desirable. However, we [R. 1495] believe that if such guidance or general rules can be developed, they must emerge from a number of individual cases in which the Commission considers this issue. Until sufficient experience under the law is acquired we believe that general statements concerning the application of the standard cannot be formulated with sufficient precision to assist those pipelines concerned with its application.

The Commission will revise section 270.205 of its regulations by adding a paragraph entitled "Modification of existing contracts." This paragraph will summarize the foregoing discussion.

(Natural Gas Act, as amended, 15 U.S.C. 717 *et. seq.*, Natural Gas Policy Act of 1978, P. L. 95-621, 92 Stat. 3350, Department of Energy Organization Act, P. L. 95-91, E. O. 12009, 42 F.R. 46267)

In consideration of the foregoing Part 270 of Subchapter H, Chapter I, Title 18, Code of Federal Regulations, is amended as set forth below, Because this is an interpretative rule, deferral of the effective date of the rule is not required. Accordingly, the rule will be effective immediately.

By the Commission. Commissioner Sheldon voted present.

(S E A L)

Kenneth F. Plumb,
Secretary

Section 270.205 is amended by redesignating paragraph (c) as paragraph (d) and by adding a new paragraph (c) to read as follows:

Sec. 270.205 Contractual authorization to collect NGPA rates.

* * * * *

(c) **Modification of existing contracts.** The NGPA does not prohibit the parties to an existent contract for the first sale of natural gas from amending or modifying such contract to permit the seller to charge and collect any applicable NGPA rate. If natural gas sold under such contract is subject to section 105(b)(1) of the NGPA and qualifies for no higher maximum lawful price under any other provision of the NGPA, no amendment or modification of such contract may provide authorization for a seller to charge and collect a price which exceeds the price under the terms of the contract as in effect on November 9, 1978.

UNITED STATES OF AMERICA [R. 1508]
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Charles B. Curtis, Chairman;
Don S. Smith, and Georgiana Sheldon.

Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations under the Natural Gas Act	))))))	Docket No. RM79-22

ORDER NO. 23-B

ORDER ADOPTING FINAL REGULATIONS AND ESTABLISHING PROTEST PROCEDURE

(Issued June 21, 1979)

I. INTRODUCTION

On March 13, 1979, Order No. 23 was issued in Docket No. RM79-22.[1] That order set forth the Commission's administrative view regarding the impact that the Natural Gas Policy Act of 1978 (NGPA)[2] would have on the operation of "area rate clauses."[3]

In Order No. 23, the Commission stated: [R. 1509]

> the Commission's regulations, . . . do not preclude the operation of price escalation provisions in a contract, the terms of which specifical-

[1] 44 F.R. 16895 (March 20, 1979).

[2] P. L. 95-621, 92 Stat. 3350.

[3] "Area rate clauses" are indefinite price escalator clauses of the character permitted under paragraph (b-1) of 18 C.F.R. 154.93.

ly permit escalation to Congressionally or legislatively authorized prices or which specifically reference Natural Gas Policy Act prices. Also, the Commission will, in the absence of specific contractual language to the contrary, generally interpose no objection to the parties to an interstate contract ascribing an interpretation to an area rate clause in its contract as would authorize escalation to, and collection of, the Natural Gas Policy Act price ceilings.

In the event that interstate pipeline purchasers contest the use or reliance by sellers on area rate clauses in their contracts, the Commission will provide an opportunity to protest. Once a protest to contractual authorization is submitted, the Commission will then consider the matter and attempt to state its view. Other parties in interest, including state commissions, local distribution companies and other aggrieved parties will be permitted to participate in any such proceeding. Also, such parties may protest the utilization of area rate clauses even in the face of agreement among the parties to the contract as to the interpretation which should be ascribed to such clauses. In this event, however, the Commission advises that considerable weight will be given to the interpretation ascribed to the contract by its parties. (footnote omitted)[4]

[4]Order No. 23, mimeo at 48-49.

The position announced in Order No. 23 was a practical one. The Commission concluded that certain area rate clauses may be triggered by the NGPA and that others may not. However, it was simply impossible for the Commission to examine each interstate natural gas contract in the proceeding in which Order No. 23 was issued. This [R. 1510] order establishes the procedure by which the Commission will determine contractual authorization to collect NGPA rates in first sales subject to the Natural Gas Act (NGA).[5]

Many applications for rehearing of Order No. 23 were received which challenged the contract law principles underlying Order No. 23. Specifically, many indicated that the Commission could do no more than look to the "four corners" of the contract to ascertain the contract's meaning.

Of course, in any dispute involving the interpretation of a contract, the "four corners" of the contract must be the initial point of departure. However, modern contract law principles allow reference "not only to the 'four corners' of the contract, but also to the circumstances surrounding the execution of the contract."[6]

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[5] *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1955) and *Federal Power Commission* v. *Sierra Pacific Power Company*, 350 U.S. 348 (1955), stand for the proposition that rate increase filings are ineffective under the NGA unless supported by contractual authority.

Of course, contracts may be amended. Order No. 23-A, issued on June 12, 1979, explicitly recognizes the right of the parties to a natural gas purchase contract to amend that contract to allow it to escalate to the highest permissible price under the NGPA. *See* 18 C.F.R. 270.205(c), as amended.

[6] Order on Rehearing of Order 23, mimeo at pages 3, 4.

Under the procedures set out below, the Commission will first look to the document itself in reviewing contracts involving natural gas subject to the jurisdiction of the Commission under the NGA. If, however, other factors need be considered to interpret the contract, these procedures will afford an opportunity for the presentation of evidence respecting such factors. [R. 1511]

Orders 15,[7] 15A,[8] and 25[9] established special Natural Gas Act section 4 rate-change filing procedures for purposes of collecting the higher rates permissible under the NGPA. Under these orders, the requirements of NGA section 4 were deemed to be satisfied by either a blanket affidavit or interim or retroactive collection filing.[10] Protests could be made with respect to any of these filings. By this order, the Commission establishes "a general protest procedure in which parties in interest can petition the Commission for a specific determination as to whether a particular contract clause constitutes the requisite authority to charge and collect Natural Gas Policy Act rates."[11] [R. 1512]

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[7]Docket No. RM79-4, issued November 17, 1978; 43 F.R. 55756 (November 29, 1978).

[8]Docket No. RM79-4, issued December 28, 1978; 44 F.R. 1100 (January 4, 1979).

[9]Docket No. RM79-31, issued March 27, 1979; 44 F.R. 19387 (April 13, 1979).

[10]The filings were specifically stated *not* to abrogate any contractual right to receive gas at a lower price than the NGPA ceiling rate. See 18 CFR 154.94(h)(7) and (i)(2).

[11]Order No. 23, mimeo at 52. This procedure is only applicable to rate-increase filings involving natural gas which is subject to the jurisdiction of the Commission under the Natural Gas Act.

II. DISCUSSION OF COMMENTS

On May 2, 1979, the Commission issued a Notice of Inquiry in this docket, requesting comments on the appropriate procedure to be utilized in evaluating protests to contractual authority. Specifically, comments were requested on whether a pipeline's Purchased Gas Adjustment (PGA) hearing would be an appropriate forum to deal with such protests, and whether natural gas contracts could be grouped generically for decisional purposes.

Seventeen comments were received to our Notice of Inquiry. The vast majority of them strenuously objected to the use of the PGA as the forum to resolve contractual disputes. They were more evenly split on the question of generic grouping of contracts; potential third-party protestors favored generic grouping, producers and pipelines were generally opposed.[12] [R. 1513]

The Commission considered the alternative of examining the question of contractual authorization in the context of pipeline PGA proceedings. While the Commission is of the view that the question will lend itself to resolution on a pipeline-by-pipeline basis, the PGA proceeding is not the proper forum. The specialized nature of contractual authorization questions and the length of time necessary to dispose of them would, as most comments point out, complicate proceedings. Therefore, the Commission will sever these questions from the PGA proceedings and re-

[12]The Commission indicated in the Order on Rehearing of Order No. 23, in footnote 4, that the procedural issues raised by the applications for rehearing of Order No. 23 would be considered in determining the appropriate procedure to be implemented. Most of the applications for rehearing simply objected to the protest procedure set forth in Order No. 23. The specific proposals made in the applications for rehearing were repeated in the responses to the Notice of inquiry.

quire that evidence as to contractual authorization which would hve been submitted in the PGA proceeding be separately presented in the protest proceedings established under this order.

The Commission cannot make a general rule involving the appropriateness of grouping contracts for purposes of decision. The procedure adopted herein requires that decision to be made on an *ad hoc* basis by the Chief Administrative Law Judge. [R. 1514]

Some comments indicated that the protest procedure under our present regulations was adequate. Others made specific proposals concerning the appropriate procedure to handle protests to assertions of contractual authority. The Commission has concluded that the present procedure is inadequate, largely because it does not afford potential protestors adequate opportunity to focus on specific contracts, file specific protests, and have the parties' assertions evaluated.

Several commentors would have the Commission require producers to make new filings for each contract, in which the producer would state the foundation for his belief that contractual authority to collect the NGPA maximum lawful price exists. Each comment suggested slightly different ways to process protests to these filings.

As more fully discussed below, the Commission will require pipelines, not producers, to file this additional information. However, certain aspects of the procedures suggested by the comments have been adopted.

Three comments asserted that a limited number of hearings be held. They suggested a large proceeding dealing with a representative sampling of a natural gas contracts, or a few proceedings to set precedents. One Public Service Commission went so far as to say it had "no interest in [R. 1515]

relitigating for each rate schedule questions which, as a result of test cases, are settled insofar as the Commission is concerned."

The Commission cannot accept these suggestions. Despite the administrative burden, the Commission feels that it must provide an opportunity for an interested party to challenge any contract which that party feels does not constitute contractual authority to change the NGPA rate.

One comment suggested a "bifurcated" procedure, one for "typical" area rate clauses where no hearing would be provided, and another procedure for all others which would provide for hearings. The Commission has adopted this procedure, although the distintion between those protests which can or cannot be resolved with a hearing is not based on whether or not the contract is "typical." It is questionable if any escalation provisions could accurately be characterized as "typical." Therefore, the initial distinction will be made based on whether the language of a particular contract is inconsistent with the claim of the parties to the contract that there is authority to collect the higher NGPA rate. If the language of the contract is inconsistent [R. 1516] with that interpretation, a hearing will be ordered. If there is no inconsistency, the protest will be summarily dismissed, unless specific evidence is filed which may explain or modify the text of the contract.[13] To the extent possible, contracts with similar language will be dealt with generically.

One comment suggested that the hearing officer be allowed to decide specific procedural questions involving a protest before him. This suggestion has been adopted. The

[13]The Commission contemplates a procedure similar to its practice of requiring prefiled testimony in pipeline and electric rate cases.

Commission has delegated to the Chief Administrative Law Judge the responsibility to set protests for hearing, sever and consolidate proceedings, and certify questions to the Commission. Further, the Administrative Law Judge to whom a particular protest is assigned may be authorized by the Chief Administrative Law Judge to issue similar procedural orders regarding that protest. Such a device was necessary to allow an expeditious treatment of what is anticipated to be a large volume of protest.

Several parties suggested that the burden of proof in any protest proceeding should be on the producer rather than the protestor. We specifically address this issue below.

II. THE PROCEDURE [R. 1517]

The Commission has concluded that evidence claimed to authorize increased rates due the passage of the NGPA should be made available for use in the protest proceedings respecting NGA rate-increase filings under 18 C.F.R. 154.94(h) or (i). However, we have determined that jurisdictional pipeline companies should submit such evidence rather than producers. This decision is predicated upon the Commission's view that interstate pipelines are in a much better position to supply the needed evidence than are producers. First, we presume that the pipelines in the regular course of business will review relevant contractual provisions prior to making a decision whether to protest the blanket affidavit or interim or retroactive collection filings. Second, there are far fewer interstate pipelines than producers, thus there will be fewer filings. Because of the large number of producers, it would be difficult to assure that all of the needed evidence would be submitted in a timely fashion. Third, because some producers conduct extremely small operations, imposing an additional filing burden on them would create more of a hardship

than upon interstate pipelines. Fourth, it is anticipated that interstate pipeline contracts will fall into a limited number of generic categories, thus allowing protests to be made on a generic basis in some cases. Finally, interstate pipelines are in a much better position than producers to provide interested parties with copies of such evidentiary filings, much in the same manner as they presently are required to serve their customers with their PGA filings. [R. 1518]

Each pipeline which purchases natural gas for resale must file with the Commission the following evidence: 1) the rate schedule number, (or if there is none, the date of the contract) for each of its contracts for which the seller has made a rate increase filing under 18 C.F.R. 154.94(h) or (i); 2) the name of the seller for each such contract; 3) the section or sections of the NGPA which are applicable to the first sales under each contract; 4) the text of the contractual provisions as well as any other evidence[14] which the pipeline believes constitutes or may constitute the contractual authority to escalate the price to the NGPA ceiling. Further, the pipeline shall list those contracts for which the pipeline and seller disagree on the question of contractual authority to collect a higher rate under the NGPA. [R. 1519]

These evidentiary submissions are required to be filed before August 15, 1979, with the Commission as well as to those state commissions and pipeline customers that specifically request the pipeline to provide them with a

[14]This evidence may take many forms. For example, the course of conduct of the parties subsequent to the execution of the contract may evince a modification of its original terms. See *Sam Rayburn Dam Electric Cooperative* v. *FPC*, 515 F.2d 998, 1007 (D.C. Cir., 1975), cert. den. U.S. 907 (1976).

copy.[15] The submissions should enable these parties to identify the contracts which affect their interests and to determine whether the language of a particular contract is consistent with the parties' assertion that the contract authorizes escalation to the NGPA maximum lawful price.

Protests may be filed before August 15, 1979, by pipelines and before October 15, 1979, by third parties (i.e., persons not a party to the contract).[16] All protests will be noticed in the Federal Register and will be forwarded to Chief Administrative Law Judge for assignment to an Administrative Law Judge for review. The Commission is vesting in the Chief Administrative Law Judge authority to set proceedings for hearing and to issue such procedural orders as may be necessary to expeditiously consider the large volume of protests which may arise under Order No. 23.[17] The Commission anticipates that the Chief Administrative Law Judge will group protests and deal with them on a pipeline-by-pipeline basis unless he finds another procedure is more efficient. Under this procedure [R. 1520

[15]To the extent that the filing deadline or information required by a submission impose a hardship on any pipeline, adjustment relief is available under § 1.41 of the Commission's regulations.

[16]Within the constraints imposed by the Commission's limited resources, the Commission expects that Staff will endeavor to examine the pipeline reports and challenge the interpretation ascribed to a particular contract by its parties if that interpretation appears to be inconsistent with the text of contract or with other information known to Staff. If it appears to Staff that the requisite contractual authority does not exist to support an NGA rate-change filing, it may contest the filing and request a hearing before an Administrative Law Judge in the same manner as a third party protestor.

[17]The Commission's Rules of Practice will apply to such procedural orders except to the extent the orders make inapplicable a specific provision of the Rules of Practice. However, § 1.28 of the Rules of Practice, relating to certification of questions to the Commission, is applicable to any procedural order of the Chief Administrative Law Judge under this provision.

protests to contracts containing substantially identical area rate clauses can be handled generically by an Administrative Law Judge, if deemed appropriate.

Protests will be preliminary reviewed by an Administrative Law Judge to determine if a hearing is necessary. Hearings will be initiated pursuant to 18 C.F.R. [R. 1521]
154.94(i)(4) whenever the Chief Administrative Law Judge (or if a procedural order of the Chief Administrative Law Judge so provides, the Administrative Law Judge to whom the protest is assigned) determines a hearing is necessary.

Each protest, whether by a third party or by the first sale purchaser shall include the text of the contractual provisions which the protestor believes is inconsistent with a conclusion that the gas purchase contract auth rizes the collection of the higher rate for which he has filed. Additionally, the protest may include any other evidence relied upon by the protestor to support his position of lack of contractual authority.[18]

The rule provides that the Chief Administrative Law Judge (or if a procedural order of the Chief Administrative Law Judge so provides, the Administrative Law Judge to to whom the protest is assigned) may summarily dispose of a protest. The rule does not specify the grounds on which summary disposition can be made; summary disposition must be left initially to the judgment of the Administrative Law Judge, and ultimately to the judg- [R. 1522]
ment of the Commission, upon review of the Administrative Law Judge initial decision. However, the Commission will provide the following guidelincs for summary dispositions of third party protests where the parties

[18]Those protests which have already been filed with the Commission should be amended to incorporate these requirements.

to the contract agree that contractual authorization exists. § 270.205(a)(2) provides that a contractual provisions similar to the area rate clause permitted by § 154.93(b-1) "*generally*" will be considered contractual authorization to collect an NGPA rate to the extent the parties intended to authorize collection of NGPA rates under the contract. Where the parties state that their intent was to authorize collection of the rates, "considerable weight" will be given to their interpretation.[19] However, the Commission cannot allow the parties' interpretation to be dispositive where that interpretation does not appear to be reasonable in light of the language of the contract and the conduct of the parties. Therefore, the Commission will permit third parties to utilize the protest procedure to present evidence of lack of contractual authorization. However, in such circumstances, the burden of going forward with evidence of lack of contractual authorization is appropriately placed on the third party protestor. Unless the third party protestor can show that the language of the contract is inconsistent with the parties' interpretation, or can include in his protest (or in a supplemental filing) evidence sufficient to show lack of contractual authorization, there is no basis for finding that the parties' conclusion is unreasonable, and the protest should be summarily dismissed. [R. 1523]

If the protest is not summarily dismissed, it will be set for hearing. Any interested party, including the first seller, may intervene in a hearing. At the hearing, the burden of persuasion will be on the parties to the contract to establish their position by a preponderance of the evidence.

For all blanket affidavits and interim or retroactive collection filings made after June 15, 1979, an additional evidentiary submission must be filed with the Commission and interested parties by the pipeline within 60 days of

[19]Order No. 23 mimeo at 49.

receiving notice of such filings. Pipeline protests likewise must be submitted within 60 days of the filings. Third party protests must be submitted within 120 days of the date of the blanket affidavit or interim or retroactive collection filing. These protests to later filings will be handled similarly to the protests to the pre-June 15, 1979, filings.

If a pipeline contests its seller's contractual right to charge and collect a higher rate due to the passage of the NGPA, that pipeline may pay the higher rate subject to refund, or it may refuse to pay the higher rate until the dispute has been resolved. If a third party protestor challenges that contractual authority, in the face of agreement of the parties, the payment by the pipeline is subject to refund. In these cases, as in any case involving natural gas which is subject to the jurisdiction of the Commission under the NGA, if a rate-increase filing is not supported by contractual authority, the rate-increase filing is a nullity, and any rate charged under that filing is subject to refund.[20] [R. 1524]

IV. PUBLIC PROCEDURES AND EFFECTIVE DATE

The Commission is making these rules effective on June 21, 1979, the date of the issuance of this order. A general right to protest was set forth in Order No. 23, issued March 13, 1979. A Notice of Inquiry requesting suggestions regarding that procedure was promulgated on May 2, 1979. Both the Applications for Rehearing of Order No. 23, and the comments received in response to the Notice of Inquiry, made suggestions as to the appropriate procedure to be implemented. The rules and amendments contained herein were developed in consideration of those [R. 1525]

[20] *Shell Oil Company* v. *FPC*, 334 F2d. 1002 (3rd Cir. 1964).

suggestions and comments. Accordingly, the Commission finds that further notice and public procedures on these rules is unnecessary, impracticable and that good cause exists to dispense with additional notice and procedure, and to make these rules effective upon the issuance of this order.

(Natural Gas Act, as amended, 15 U.S.C. 717, *et seq.;* Department of Energy Organization Act, P.L. 95-91; E.O. 12009, 42 F.R. 4627, Natural Gas Policy Act of 1978, P.L. 95-621.)

In consideration of the foregoing, Part 1 of Subchapter A, and Parts 154 and 260 of Subchapter E, Chapter I, Title 18, Code of Federal Regulations, are amended as set forth below.

By the Commission.

(SEAL)

/s/
Kenneth F. Plumb,
Secretary.

1. Section 154.94 is amended by revising subparagraph (h)(8) and subparagraph (i)(3) to read as follows: [R. 1526]

(h) **Blanket filing.**

* * * * *

(8) **Protests.** Any protest to a blanket affidavit shall be submitted

(i) in the case of a protest by the purchaser in the first sale, within 60 days from the filing of the blanket affidavit or August 15, 1979, whichever is later, or

(ii) in any other case, within 120 days from the date of the filing of such blanket affidavit, or October 15, 1979, whichever is later.

* * * * *

(i) **Interim and retroactive collections.**

* * * * *

(3) **Protests.** Any protest to an interim or retroactive collection filing shall be submitted

(i) in the case of a protest by the purchaser in the first sale, within 60 days from the date of such filing or August 15, 1979, whichever is later, or

(ii) in any other case, within 120 days from the date of such filing, or October 15, 1979, whichever is later.

(iii) If protest is made with respect to a filing under paragraph (i)(1) of this section, on the grounds of lack of contractual authorization, then notwithstanding [R. 1527] § 273.302(f) of this chapter, any refund obligation under § 273.302 of this chapter, shall continue until contractual authorization is established or until refund is made in accordance with the direction of the Commission.

2. Section 154.94 is further amended by adding at the end thereof the following new paragraph:

(j) *Evidentiary submission by pipeline; protest procedure.*

(1) **Evidentiary submission.** Each interstate pipeline which purchases natural gas in a first sale and sells such gas for resale shall file an evidentiary submission which shall include:

(i) the rate schedule number assigned by the Commission (or if none has been assigned, the date of the contract) for each contract for each first sale of natural gas for which the seller has made a rate-increase filing under paragraph (h) or (i);

(ii) The name of the seller for each contract listed in clause (i);

(iii) the section or sections of the NGPA which are applicable to each first sale of natural gas under each contract listed in clause (i);

(iv) (A) a statement specifying whether or not, in such [R. 1528]
pipeline's opinion the seller has contractual authority to collect the filed for NGPA rate, and (B) the text of any contract provisions, and any other evidence, which the pipeline believes constitutes, or may constitute, contractual authority for the seller to charge and the pipeline to pay a maximum lawful price under the NGPA; and

(v) The rate schedule number (or if none has been assigned, the date of the contract) for each natural gas contract listed in clause (i) with respect to which the pipeline has filed protest under paragraph (h)(8) or (i)(3) on grounds of lack of contractual authorization.

(2) **Filing.** The evidentiary submission required by subparagraph (1) shall be filed with the Commission, and on request, with each state commission and each interstate pipeline, local distribution company or other person served by such pipeline. Such submission shall be filed not later than August 15, 1979, or 60 days after the date on which the pipeline has received notice of the filing with the Commission pursuant to § 273.202(d)(iii) of this chapter or paragraph (h)(6) of this section, whichever is later.

(3) **Contents of protest.** Each protest filed under paragraph (h)(8) or (i)(3) shall set forth the text of the contractual provisions which the protestor believes is inconsistent with the conclusion that the contract authorizes the seller to collect the filed for NGPA rate, and may include any other evidence which the protestor believes is relevant to the issue of the existance of contractual authorization to collect the NGPA rate. [R. 1529]

(4) **Protest Procedure**

(i) Each protest filed under paragraph (h)(8) or (i)(3) shall be notice in the *Federal Register* and transmitted to the Chief Administrative Law Judge for assignment to an Administrative Law Judge. A protest will be set for hearing unless summary disposition is made of the protest.

(ii) If a protest is set for hearing, any interested party, including the first seller, may intervene.

(5) **Authority of Chief Administrative Law Judge.**

(i) In the case of any proceeding relating to a protest filed under paragraph (h)(8) or (i)(3), the Chief Administrative Law Judge is authorized to issue such procedural orders, including orders setting matters for hearing, severing and consolidating proceedings, certifying questions to the Commission, as he determines necessary

or appropriate for the expeditious consideration of such protests. The Chief Administrative Law Judge may, by such order, authorize the Administrative Law Judge to whom a protest is assigned to issue similar procedural orders relating to that protest.

(ii) Part I of the Commission's regulations (relating to rules of practice) shall apply to such protest proceedings except to the extent otherwise provided by a procedural order under clause (i). Section 1.28 shall apply to any procedural order under clause (i). [R. 1530]

(6) *Definitions.* For purposes of this paragraph the terms "first sale" and "interstate pipeline" have the same meaning as they do under section 2 of the NGPA.

UNITED STATES OF AMERICA [R. 1696]
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Charles B. Curtis, Chairman;
Georgiana Sheldon, Matthew Holden, Jr.

Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act	))))))	Docket No. RM79-22

ORDER ON REHEARING OF ORDER NO. 23-B
(Issued August 6, 1979)

On June 21, 1979, the Federal Energy Regulatory Commission (Commission) issued Order No. 23-B[1] in Docket No. RM79-22. That order established "a general protest procedure in which parties in interest can petition the Commission for a specific determination as to whether a particular contract clause constitutes the requisite authority to charge and collect Natural Gas Policy Act rates."[2]

Fifteen applications for rehearing of Order No. 23-B were timely filed.[3] Several made helpful suggestions which have been adopted.

[1]44 F.R. 38834 (July 3, 1979).

[2]Order No. 23 at 52 (44 F.R. 16895, March 20, 1979). For purposes of this order "assertions of contractual authority" refers to the assertion of the contractual authority to charge and collect a maximum lawful price under the Natural Gas Policy Act of 1978 (NGPA).

[3]See appendix for list of those who submitted applications for rehearing.

I. *Burden of Proof*

Order No. 23-B addressed the proper distribution of the burden of proof in cases involving a third party protest to an assertion of contractual authority by the parties to the contract. That order allocated the initial burden of going forward (also known as the burden of production) upon the third party protestor, to establish that the contract did not constitute such authority. If that burden is satisfied, a hearing will be held; if not, the third party protest will be summarily dismissed. At the hearing, Order No. 23-B set the burden of persuasion upon the parties to the contract; to prevail in their position, the parties must prove by a preponderance of the evidence that the contract does constitute the requisite contractual authority.

Almost every application for rehearing objected to this allocation of the burden of proof. Potential third party protestors, as well as the potential opponents of such protest took similar, mirror-image positions: the full burden should be on the other side. Basic evidence law and the Administrative Procedure Act were cited by both sides in support of their contrary positions. The Commission will not change this allocation of burdens, but we will further amplify the respective burdens, and attempt to give additional guidance to the Administrative Law Judges in determining whether the third party protestor's burden of production has been met. [R. 1698]

As stated in Order No. 23-B, and earlier in Order No. 23, "considerable weight" will be given to the interpretation ascribed to a contract by the parties to the contract. In essence, this statement reflects a presumption that (1) the parties to a natural gas purchase contract should know what their intent was when they executed the contract, and (2) those parties are truthful in an assertion regarding that

intent. Thus, when a pipeline and a producer assert in a filing to the Commission that a particular contract authorizes the collection of an NGPA maximum lawful price, the Commission will presume that assertion is accurate.[4] If [R. 1699] nothing more is shown, that presumption will stand.

However, the presumption may be rebutted by a third party protestor, by coming forward with enough evidence to show that there is not contractual authority to charge and collect the NGPA rate. That showing must involve more than a "scintilla" of evidence; it must be such that a reasonable man could infer that contractual authority does not exist.[5]

If the third party protestor's burden of production is satisfied, a hearing will be held. However, as stated previously, the burden of persuasion will be upon the parties to the contract to establish their position by a preponderance of the evidence.[6] The burden of persuasion is properly placed on the parties to the contract because they have much easier access to the information which is [R. 1700] relevant to the issue of contractual intent.

The Commission also should address the burden of proof involving a protest by a party to a natural gas contract. In such case, the protestor will have no burden of going forward, because there is no presumption to overcome. Further, the burden of proof in such a case will be entirely on the party seeking the rate increase.

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[4]Associated Gas Distributors requested that the pipeline evidentiary filings be made under oath. This will not be required. The penalties for false filings contained in 18 U.S.C. 1001 apply to such filings whether or not the filing is made under oath.

[5]*See* McCormick on Evidence, 2nd Ed, at page 769.

[6]The Commission's view of presumptions is consistent with Section 301 of the Federal Rules of Evidence.

One application for rehearing requested that Order No. 23-B should provide for the summary grant of a protest. The Commission believes there cannot be a summary granting of a third party protest in the face of the parties' assertion of the existence of contractual authority to charge and collect NGPA rates. In such a case, even if the contract on its face apparently will not support an assertion of contractual authority, that contract must be interpreted in light of the commercial context of the contract; the parties must have an opportunity to establish that context.

II. *Evidentiary Submissions*

Several comments addressed the evidentiary filings required to be made by interstate pipelines. The most obvious defect in the requirement was noted by Transcontinental Gas Pipeline Corporation: Order 23-B limited the required evidentiary submissions by interstate pipelines to those contracts for which a blanket affidavit was filed or for which an interim or retroactive collection filing was made. *See* § 154.94(h) and Part 273 of the Commission's regulations. This limitation left out small producer contracts, because small producers do not make such filings. [R. 1701]

There is no basis for treating small producer contracts differently than other contracts for purposes of determining whether there is contractual authority to charge and collect a maximum lawful price set by the NGPA. Accordingly, the Commission has amended the small producer regulations in § 154.40 to allow a protest to be made to an assertion by a small producer that the requisite contractual authority exists. Conforming amendments have been made in § 154.94(j) to include reference to these protests. However, the pipelines will not be required to submit the information regarding small producers until September 5, 1979. *See* § 154.94 (j)(2)(i).

Several other defects were pointed out by other parties. The rules will be amended to include the following changes:

(1) producers will be allowed, in § 154.94(j)(2)(i), to request a copy of an evidentiary submission that relates to that producer, and to request from the pipeline a list of the parties served with a copy of the evidentiary filing. [R. 1702]

(2) producers will be allowed, in § 154.94(j)(2)(ii), to file additions to the evidentiary filings submitted by the pipeline.

(3) pipelines will not be required to resubmit information that has previously been filed in a prior evidentiary submission. If, for example, a new well is the subject of an interim collection filing, and the information is contained in a prior evidentiary submission, the pipeline will satisfy the requirements of § 154.94(j)(1) by simply refering to the prior filing. See § 154.94(j)(1)(vi).

No other changes will be made in the required evidentiary filings. If additional information is required by a third party protestor, access to the entire contract is available both in the Commission's files and in the public files of each natural gas company. See § 154.1 of the Commission's regulations. The present filing requirements will supply potential protestors the opportunity to identify and protest those contracts in which they may have an interest.

III. *Protests.* [R. 1703]

Several producer comments focused on the issue of adequate notice of a protest to the parties to the contract. As correctly pointed out by the Indicated Producers, Order

No. 23-B is defective because it does not provide specific notice to the parties to the natural gas purchase contract. Accordingly, § 154.94(h)(8) and (i)(3) have been amended to include a requirement that a protest be served with the producer, in the case of a protest by the purchaser, and on both the producer and purchaser, in the case of a third party protest.

Several applications for rehearing indicated a strong belief that producers should be *required* to be joined as parties in a case resulting from a third party protest, rather than be *allowed* to intervene. The Commission agrees, since the issues raised by a protest always will involve the rights of the producer, and any order by the Commission as a result of a protest would effect those rights. Consequently, § 154.94(j)(4)(ii) has been amended to reflect this view.

The Commission disagrees with the suggestion that the regulations should limit who can file a protest. The Commission believes that the public interest is not served by at- [R. 1704]
tempting to limit the class of persons who may protest an assertion of contractual authorization. If a "standing" requirement were imposed, substantial resources of the protestor, producer, purchaser and the Commission would have to be expended in determining that issue, rather than the more fundamental question of the existance contractual authority. For these reasons, the Commission will not impose limitations upon who may file a protest.[7]

However, the Commission wishes to make it clear that protests must specifically identify the contract which it addresses. Further, the protestor must state the reasons why he believes that any particular contract is inconsistent with

[7]Staff also may file protests; staff protests will be treated the same as other third party protests.

the conclusion that it constitutes contractual authority to charge and collect the NGPA rate. Thus, "blanket protest" which apply to all natural gas purchase contracts will be summarily dismissed as not having met the burden of production *See* § 154.94(j)(3).

The Commission also wishes to clarify, pursuant to the request of the New York Public Service Commission, the meaning of the words "supplemental filing" on page 16 of [R. 1705] Order 23-B. The Commission intends that a protest may be supplemented by additional information, if the additional information is submitted before the protest is resolved by summary dismissal or before the hearing.

IV. *Jurisdiction under the Natural Gas Act.*

Several of the parties filing applications for rehearing objected to the Commission's position, taken in the Order on Rehearing of Order No. 23, issued May 11, 1979, that the Commission would interpret only contracts involving natural gas which was subject to the jurisdiction of the Commission under the Natural Gas Act ("NGA gas"). Shell Oil Company, on the other hand, objected to allowing protests to be filed to interim collections involving "NGA gas" which will become "non-NGA gas" as soon as a final determination is made that the gas falls within one of the categories governed by NGPA section 601(a)(1)(B), (as soon as such a determination becomes final, the "NGA gas" becomes "non-NGA gas").

The Commission will adhere to its previously stated position: "NGA gas" contracts are within the scope of the Commission's duty to ascertain whether contractual authority exists for a rate increase. There is no such duty for "non-NGA gas." And specifically addressing Shell [R. 1706] Oil's concern, even if "NGA gas" will soon become "non-

NGA" gas, the duty continues *until* the gas becomes "non-NGA gas." Thus, protests concerning the gas covered by NGPA section 601(a)(1)(B) will be considered but the Commission's interpretation will govern only those deliveries made before the determination becomes final.

The Commission orders:

Except to the extent previously discussed, the applications for rehearing of Order 23-B are denied.

This order on rehearing amends the rules set forth in Order 23-B which will become effective as final rules August 15, 1979. In Order 23-B the Commission found that further notice and public procedures on the rules promulgated in Order 23-B was unnecessary and impracticable, and that good cause existed to dispense with additional notice and opportunity for comment. For the same reasons as were articulated in Order No. 23-B, the Commission makes the same finding with respect to this order on rehearing.

(Natural Gas Act, as amended, 15 U.S.C. 717 *et seq.;* Department of Energy Organization Act, 42 U.S.C. 7107, *et seq.;* E.O. 12009, 42 F.R. 46267; Natural Gas Policy Act of 1978, P.L. 95-621).

In consideration of the foregoing, Parts 154 and 157 of Subchapter E, Chapter I, Title 18, Code of Federal Regulations, are amended as set forth below. The changes in the rules contained herein are procedural, and thus the thirty-day requirement of 5 U.S.C. 553(d) does not apply. In addition, it is necessary, in view of the need to coordinate these changes with the rules promulgated in Order

No. 23-B, to make these amendments effective on August 15, 1979.

By the Commission.
(S E A L)

Lois D. Cashell,
Acting Secretary.

1. Section 154.94 is amended in paragraphs (h), (i) and (j) to read as follows: [R. 1708]

§ 154.94 Changes in rate schedules.

* * * * *

(h) Blanket filings.

* * *

(8) Protests. Any protest to a blanket affidavit shall be submitted to the Commission and the producer

(i) In the case of a protest by the purchaser in the first sale, within 60 days from the filing of the blanket affidavit or August 15, 1979, whichever is later, or

(ii) In any other case, within 120 days from the date of the filing of such blanket affidavit, or October 15, 1979, whichever is later. A protest filed under this clause (ii) shall also be served upon the purchaser in the first sale.

(i) Interim and retroactive collections.

* * *

(3) Protests. (i) Any protest shall be submitted to the Commission and to the producer

(A) In the case of a protest by the purchaser in the first sale, within 60 days from the date of such filing or August 15, 1979, whichever is later; or

(B) In any other case, within 120 days from the date of such filing, or October 15, 1979, whichever is later. A protest filed under this clause (B) shall also be served upon the purchaser in the first sale. [R. 1709]

(ii) If a protest is made with respect to a filing under paragraph (i)(1) of this section, on the grounds of lack of contractual authorization, then notwithstanding

§ 273.302(f) of this chapter, any refund obligation under § 273.302 of this chapter shall continue until contractual authorization is established or until refund is made in accordance with the direction of the Commission.

(j) Evidentiary submission by pipeline, protest procedure. (1) Evidentiary submission. * * *

(i)(A) The rate schedule number assigned by the Commission for each contract for each first sale of natural gas for which the seller has made a rate increase filing under paragraph (h) or (i) of this section;

(B) The date of the contract for each first sale of natural gas by a small producer for which the small producer has asserted the right to collect the maximum lawful price under the NGPA.

* * *

(v) The rate schedule number (or if none has been assigned, the date of the contract) for each natural gas contract listed in subparagraph (1)(i) of this paragraph with respect to which the pipeline has filed a protest on grounds of lack of contractual authorization under paragraph (h)(8) or (i)(3) of this section or under § 157.40(1)(c)(v)(B). [R. 1710]

(vi) Any requirement of this section for data which has previously been submitted in an evidentiary submission under this section may be satisfied by a specific reference sufficient to locate the data in the prior evidentiary submission.

(2) Filing. (i) The evidentiary submission required by subparagraph (1) of this paragraph shall be filed with the Commission and, on request, with the seller in the first sale, and any State Commission, interstate pipeline or

local distribution company. In the case of all contracts except small producer contracts, the evidentiary submission shall be filed not later than August 15, 1979, or 60 days after the pipeline received notice of a filing pursuant to § 273.202(d)(iii) of this chapter or paragraph (h)(6) of this section, whichever is later. In the case of small producer contracts, as defined in § 157.40(a), the evidentiary submission shall be filed no later than September 1, 1979, or, [R. 171
not later than 60 days after the date on which the pipeline knew or should have known of the seller's assertion of contractual authority to charge and collect a maximum lawful price under the Natural Gas Policy Act of 1978, whichever is later. In either case, the seller in the first sale may request a service list of the parties served with the evidentiary filing.

(ii) The seller in the first sale may submit, to the Commission and any other party served with the evidentiary submission, any supplemental information deemed relevant to the evidentiary submission.

(3) *Contents of protests.* Each protests filed under paragraph (h)(8) or (i)(3) of this section or § 157.40(c)(1)(v)(B) shall

(i) specifically identify the contract which is protested,

(ii) set forth the text of the contractual provisions which the protestor believes is inconsistent with the conclusion that the contract authorizes the seller to collect the filed-for NGPA rate, and the specific reasons why the protestor believes such inconsistency exists, and

(iii) may include any other evidence which the protestor believes is relevant to the issue of the existence of contractual authorization to collect the NGPA rate.

(4) Protest Procedure. [R. 1712]

(1) Each protest filed under paragraph (h)(8) or (i)(3) of this section or § 157.40(1)(c)(B) of this subchapter shall be notice in the *Federal Register* and transmitted to the Chief Administrative Law Judge for assignment to an Administrative Law Judge. A protest will be set for hearing unless summary disposition is made of the protest.

(ii) Upon receipt by the Commission of any protest referred to in clause (i), the seller in the first sale shall be joined as a party.

(5) Authority of Chief Administrative Law Judge.

In the case of any proceeding relating to a protest filed under paragraph (h)(8) or (i)(3) of this section or under § 157.50(1)(c)(v)(B), the Chief Administrative Law Judge is authorized to issue such procedural orders, including orders setting matters for hearing, severing and consolidating proceedings and certifying questions to the Commission, as he determines necessary or appropriate for the expeditious consideration of such protests. The Chief Administrative Law Judge may, by such order, authorize the Administrative Law Judge to whom a protest is assigned to issue similar procedural orders relating to that protest. [R. 1713]

(ii) * * *

(6) Definitions. * * *

2. Section 157.40(c)(1) is amended in clause (v) by inserting "(A)" at the beginning thereof and by adding subclause (B) to read as follows:

§ 157.40 Exemption of small producers from certain filing requirements.

* * * * *

(c)(1) * * *

(v)(A) * * *

(B) Any protest to an assertion of contractual authority to charge and collect a maximum lawful price under the NGPA shall be submitted to the Commission, and to the small producer:

(1) In the case of protest by the purchaser in the first sale, within 60 days from the date on which the purchaser knew, or should have known, of the assertion, or September 1, 1979, whichever is later; or

(2) In any other case, within 60 days after the date on which the evidentiary submission referencing such contract was filed, or November 5, 1979, whichever is later. A protest filed under this clause (2) shall also be served upon the purchaser in the first sale. [R. 17

UNITED STATES OF AMERICA [R. 1717]
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Charles B. Curtis, Chairman;
Matthew Holden, Jr., and George R. Hall.

Amendment and Clarification of Interim Regulations Under the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act	)))))	Docket No. RM79-22

ORDER ON REHEARING OF ORDER NO. 23-A
(Issued August 13, 1979)

On June 12, 1979, the Federal Energy Regulatory Commission issued Order No. 23-A in Docket No. RM79-22. Order No. 23-A held, in essence, that the parties to a natural gas purchase contract may make amendments to that contract to provide contractual authority to charge and collect the applicable maximum lawful price under the Natural Gas Policy Act of 1978 (NGPA). Five applications for rehearing of Order No. 23-A were received, from the people of the State of California and the California Public Utilities Commission of the State of California (California), the Public Service Commission of the State of New York (New York), Kaiser Aluminum and Chemical Corporation (Kaiser), Associated Gas Distributors (AGD), and from Pennzoil Oil and Gas Inc. and Pogo Producing Company (Pennzoil and Pogo). None of the applications for rehearing have presented the Commission with sufficient cause to modify the rule promulgated in Order No. 23-A, but the Commission will address the issues of general applicability that were raised by the applicants for rehearing. [R. 1718]

Three applications for rehearing addressed the issue of pipeline pass through of increased rates which result from

contract amendments. California stated the Commission abused its discretion by not requiring contract modifications to be supported by additional consideration. New York takes the position that Order No. 23-A is essentially silent on the issue of pipeline pass through. AGD states that the public interest requires, at a minimum, a promise by the producer to commit new gas reserves to the pipeline as consideration for an amendment increasing the purchase price under a natural gas purchase contract.

The Commission stated in Order No. 23-A that "general statements concerning the application of the [fraud, abuse, or similar grounds] standard cannot be formulated to assist those pipelines concerned with its application." The Commission adheres to its previously stated position that it is impossible at this time to formulate a general rule defining what fact pattern would require a finding of "fraud, abuse or similar grounds."

On a related point, AGD requested that a procedure be established, similar to that adopted in Order No. 23-B, to allow interested parties to protest a contract amendment. [R. 1719] Specifically, AGD would have all amended contracts be reported to the Commission; the report would contain all relevant information regarding the amendment. AGD states that the Commission has a duty to provide downstream purchasers with an opportunity to participate in contractual amendment proceedings, because downstream purchasers are third party beneficiaries.

The Commission takes no position at this time regarding the third party beneficiary status of downstream purchasers. Regardless of the resolution of that question, however, it is not the Commission's responsibility to inject itself into the contract amendment process. That process

does not involve the Commission. The only question the Commission must concern itself with is whether the pipeline may pass through the increase to its downstream purchasers. That issue can be resolved in the pipeline's purchased gas adjustment (PGA) proceeding.[1]

New York requested the Commission make clear that we have "adopted no policy, rule, guideline or presumption as to whether [contract] amendments can operate retroactively." The Commission, in this order on rehearing, wishes to make clear that it has made no such "policy, rule, guideline, or presumption." [R. 1720]

Kaiser made two requests: (1) that the Commission make clear that parties may amend the contract price of natural gas to a point below the applicable ceiling price, and (2) to authorize the parties to contracts falling within NGPA section 105(b)(1) to be allowed to amend the contract to provide for the collection of up to the section 109 maximum lawful price. The Commission does wish to make clear that the maximum lawful prices are ceiling prices only; thus, contractual amendments increasing or decreasing the contract price are permissible so long as the amended price does not exceed the maximum lawful price. Consistent with this position, however, it is impermissible to amend upwards the contract price of natural gas which

[1]There is no need for an additional report identifying those contracts that are amended. Each distribution company can examine the PGA filing of its pipeline. If the pipeline pays an NGPA maximum lawful price under an existing contract, it is doing so under one of two theories: an amendment, or an existing price escalation provision. All higher prices which are based on existing escalation provisions are reported to the downstream purchaser under Order No. 23-B. All others must be amended. By a process of elimination, the downstream purchaser can identify the amended contracts.

is subject to section 105(b)(1) (and not to any other maximum lawful price) because for section 105(b)(1) gas, the contract price is the maximum lawful price.

The Commission orders: [R. 172

The applications for rehearing of Order No. 23-A are denied.

By the Commission.
(S E A L)

Kenneth F. Plumb,
Secretary.

APPENDIX C

Section 101(b)(9) of the Natural Gas Policy Act, 15 U.S.C. § 3311 (b)(9), provides:

> EFFECT ON CONTRACT PRICE. – In the case of –
>
> (A) any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this title, or
>
> (B) any price which is established under any contract for the first sale of natural gas which is exempted under subtitle B of this title from the application of a maximum lawful price under this title,
>
> such maximum lawful price, or such exemption from such a maximum lawful price, shall not supersede or nullify the effectiveness of the price established under such contract.

Section 601 (b)(1)(A) of the Natural Gas Policy Act, 15 U.S.C. § 3431 (b)(1)(A), provides:

> FIRST SALES – Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if –
>
> (i) such amount does not exceed the applicable maximum lawful price established under title I of this Act; or
>
> (ii) there is no applicable maximum lawful

price solely by reason of the elimination of price controls pursuant to subtitle B of title I of this Act.

APPENDIX D

Section 4 of the Natural Gas Act, 15 U.S.C. § 717c, provides:

> (a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges; shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.
>
> (b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.
>
> (c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this act takes effect) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction

of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no changes shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission,

upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the

hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Section 5 of the Natural Gas Act, 15 U.S.C. § 717d, provides:

(a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* that the Commission, shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

(b) The Commission upon its own motion, or upon the request of any State commission,

whenever it can do so without prejudice to the efficient and proper conduct of its affairs, may investigate and determine the cost of the production or transportation of natural gas by a natural-gas company in cases where the Commission has no authority to establish a rate governing the transportation or sale of such naturai gas.

Opposition

Office - Supreme Court, U.S.
FILED
DEC 7 1981
ALEXANDER L. STEVAS
CLERK

No. 81-340

In the Supreme Court of the United States

OCTOBER TERM, 1981

PENNZOIL COMPANY, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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TABLE OF AUTHORITIES

Page

Cases:

FPC v. *Sierra Pacific Power Co.*, 350 U.S. 348 .. 4

Permiam Basin Area Rate Cases, 390 U.S. 747 ... 1

Richmond Power & Light v. *FPC*, 481 F. 2d 490, cert. denied, 414 U.S. 1068 4

United Gas Pipe Line Co. v. *Mobile Gas Service Corp.*, 350 U.S. 332 4

Statutes and regulation:

Natural Gas Act, 15 U.S.C. 717 *et seq.* :

Section 4, 15 U.S.C. 717c 4
Section 4(c), 15 U.S.C. 717c(c) 4
Section 4(e), 15 U.S.C. 717c(e) 4

Natural Gas Policy Act of 1978, 15 U.S.C. (Supp. IV) 3301 *et seq.* 2

Section 601(b)(1), 15 U.S.C. (Supp. IV) 3431(b)(1) 5
Section 601(b)(2), 15 U.S.C. (Supp. IV) 3431(b)(2) 5
Section 601(c), 15 U.S.C. (Supp. IV) 3431(c) 6

18 C.F.R. 154.93(b-1) 1-2

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MEMORANDUM FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

1. Contracts governing the sales of natural gas from gas producers to pipelines often contain clauses providing for increases in the price of the gas over the life of the contract. After the Federal Power Commission[1] established gas price ceilings on an area basis (*Permian Basin Area Rate Cases*, 390 U.S. 747 (1968)), the Commission authorized "area rate clauses" which

> permit a change in price to the applicable just and reasonable area ceiling rate which has been, or which may be, prescribed by the Commission for the quality of the gas involved * * *.

[1]The Federal Power Commission has been succeeded in its relevant functions by the Federal Energy Regulatory Commission.

18 C.F.R. 154.93(b-1). When the Commission later replaced area rates with a nationwide ceiling rate, producers and pipelines could lawfully use "area rate clauses" to escalate the price to that national rate even though the regulation's literal language referred to "area rates" (Pet. App. 5a).

The clauses varied widely in language, but few ever referred—in so many words—to the eventuality that Congress, rather than the Commission, might prescribe rates. In 1978, Congress passed the Natural Gas Policy Act (NGPA), 15 U.S.C. (Supp. IV) 3301 *et seq.*, which provides a series of maximum lawful prices for producer sales of natural gas. Gas producers, including petitioners, urged the Commission to hold that all producers selling under area rate clauses were automatically entitled to escalate their prices to the NGPA ceilings. Gas distribution companies and other users made the opposite argument: that none of the area rate clauses authorized NGPA prices.

In the Commission orders at issue here,[2] the Commission concluded that the area rate clauses neither required nor prohibited NGPA prices, but that as a general rule, depending on individual circumstances, the clauses could be used to collect the new prices. Because the question turned on the particular terms of each contract, the Commission set forth guidelines for deciding the intent of the contracting parties

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[2]Order No. 23, Amendment and Clarification of the Commission's Interim Regulations Implementing the Natural Gas Policy Act of 1978 and Regulations Under the Natural Gas Act, Docket No. RM79-22 (Mar. 13, 1979) (Pet. App. 82a-139a); Order on Rehearing of Order No. 23 (May 11, 1979) (Pet. App. 140a-144a); Order No. 23-A, Amendment and Clarification of Interim Regulations Under the Natural Gas Policy Act (June 12, 1979) (Pet. App. 145a-150a); Order No. 23-B, Adopting Final Regulations and Establishing Protest Procedure (June 21, 1979) (Pet. App. 151a-168a); Order on Rehearing of Order No. 23-A (Aug. 13, 1979) (Pet. App. 183a-186a); Order on Rehearing of Order No. 23-B (Aug. 6, 1979) (Pet. App. 169a-182a).

in individual cases, and prescribed procedures for that process.

The court of appeals affirmed the Commission's orders in relevant part (Pet. App. 1a-66a). The court upheld both the Commission's general rule permitting new prices to be collected under area rate clauses and the procedures adopted by the Commission for deciding contested cases (*id.* at 52a-63a). The court held (*id.* at 55a-56a; footnotes omitted; emphasis in original) that the Commission

> reasonably concluded that area rate clauses * * * could constitute sufficient authority to collect NGPA prices, subject to specific protests by pipelines or third parties. FERC reasonably concluded from the contract language and its regulatory and commercial context that it was not unreasonable for the parties to have meant to contract for whatever regulated rate was available, and not necessarily to have intended to limit the *source* of those ceilings. FERC properly limited its conclusion to a general and not conclusive rule in light of the reality that, since it is a question of the parties' intent, this conclusion may not be the case for every contract * * *.

2. The decision below is correct and does not warrant further review.

a. Petitioners contend (Pet. 21-24) that the Commission has erroneously repealed a conclusive presumption that area rate clauses constitute sufficient contractual authority to collect ceiling prices of general applicability, such as NGPA prices. At bottom, petitioners' contention amounts to a claim that all area rate clauses must, as a matter of law, be interpreted to permit collection of the maximum NGPA price applicable to the particular gas. Petitioners ultimately may prove to be correct—each and every area rate clause may be determined to authorize collection of NGPA

rates—but, under Section 4 of the Natural Gas Act, 15 U.S.C. 717c, it is the Commission's duty to make that determination.[3]

As the court below recognized (Pet. App. 21a), under *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956), and *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), any rate increase filing that is not authorized by contract is a nullity and must be rejected. Thus, it is the Commission's threshold duty under Section 4 of the Natural Gas Act to determine if the filing is valid under the contract. See *Richmond Power & Light* v. *FPC*, 481 F. 2d 490, 493 (D.C. Cir.), cert. denied, 414 U.S. 1068 (1973).

The court of appeals correctly held that the Commission reasonably exercised its duty under Section 4 in not reaching any blanket determination that all area rate clauses authorize NGPA prices. The court reasoned (Pet. App. 58a n.62):

> While there may have been a conclusive presumption that area rate clauses were sufficient authority to collect [Natural Gas Act] ceiling prices, it does not necessarily follow that [they are] sufficient authority to collect NGPA prices, since the question is whether the parties intended to collect the highest available regulated price or [had] a more narrow intent looking

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[3]Section 4(c) of the Natural Gas Act, 15 U.S.C. 717c(c), requires natural gas companies to keep current contracts and rate schedules on file with the Commission. Section 4(e), 15 U.S.C. 717c(e), allows the Commission to hold hearings on the lawfulness of any newly filed rate schedule.

It is true, as petitioners note (Pet. 10), that 10,000 protests have been filed against new rate schedules. But initial decisions have been issued in proceedings involving close to 90 % of the contested contracts. Most recommend dismissal of the protests for failure of third parties to rebut the presumption created where pipelines and producers agree that the contract permits escalation to the NGPA price.

to FPC rate proceedings. Although FERC found area rate clauses could be sufficient authority as a general rule, it is only a general rule, and the outcome properly depends upon the particular contract, its commercial and regulatory context, and the application of substantive contract law. Therefore, no conclusive presumption was unlawfully repealed.

As the court below observed, it is true that the Commission had allowed area rate clauses to trigger agency-prescribed just and reasonable rates under the Natural Gas Act. It is also true that Congress declared NGPA ceiling prices to be just and reasonable prices. 15 U.S.C. (Supp. IV) 3431(b)(2). It does not follow, however, as petitioners argue (Pet. 23-24), that area rate clauses necessarily authorize collection of NGPA rates; that depends, as the court below held (Pet. App. 58a-59a), on the parties' intent in executing their contract. The NGPA does not compel a different conclusion, since NGPA prices are *maximum* lawful prices—*i.e.*, ceilings. Prices below the ceilings are also expressly declared to be just and reasonable. 15 U.S.C. (Supp. IV) 3431(b)(1).

b. Petitioners further contend (Pet. 20) that the Commission has "no jurisdiction to interject itself or other third parties into contract interpretation," and thus may not entertain protests from consumers once the producer and the pipeline agree as to the contract's meaning. This contention was correctly rejected by the court of appeals, and we rely on its analysis here. Contrary to petitioners' approach, "[c]oncepts of administrative standing are not congruent with article III case or controversy standing requirements. * * * In the context of agency responsibility for implementation of statutory goals, a requirement of privity to raise a protest is much too narrow" (Pet. App. 59a; citations omitted).

Under Section 601(c) of the NGPA, 15 U.S.C. (Supp. IV) 3431(c), interstate pipelines are guaranteed the pass-through of NGPA prices except in cases of fraud or abuse. Thus, as the court below concluded (Pet. App. 59a-60a; footnotes omitted):

> Pipeline customers are parties in interest, even though not actual parties to the contract, because it is they who must ultimately bear the cost of any higher prices. Third party protestors therefore meet the standing requirement of 5 U.S.C. § 555(b) to lodge a protest with the Commission over the contracting parties' assertion of contractual authority. Section 555(b) provides that an interested person may appear before an agency for the presentation, adjustment, or determination of an issue, request, or controversy in a proceeding, whether interlocutory, summary, or otherwise, or in connection with an agency function. Because FERC must determine whether there is contractual authority when presented with a rate increase filing, the protest by third parties is in the nature of an intervention in an already existing proceeding, and not the initiation of a contract action against the parties to the contract. In this administrative context there is no impropriety in granting third parties standing to protest the contracting parties' interpretation.

In short, the Commission will give "considerable weight * * * to the interpretation ascribed to the contract by the parties" (Pet. App. 120a), but the parties' agreement cannot divest the Commission of its authority to reach its own determination.[4]

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[4]As petitioners note (Pet. 24), several provisions of the NGPA allow the Commission to establish higher rates than those fixed by Congress in the Act. But whether area rate clauses will be interpreted to allow

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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collection of any Commission-established higher NGPA price, as petitioners claim, is a hypothetical question not presented by this case. The question has not been addressed by the Commission, let alone reviewed by the court below.

DOJ-1981-12